THE MONEY MARKET

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CONTENTS

CHAPTER I

PAGE

THE BEGINNING OF BANKING IN ENGLAND . . . 1

CHAPTER II

THE FOUNDATION AND GROWTH OF THE BANK OF ENGLAND 7

CHAPTER III

THE EARLY PRIVATE BANKERS 19

CHAPTER IV

THE BANK CHARTER ACT OF 1844, AND ITS SUSPENSIONS 28

CHAPTER V

THE DEVELOPMENT OF LONDON AS THE FINANCIAL CENTRE OF THE WORLD 41

CHAPTER VI

FACTORS OF THE MONEY MARKET . . . 47

CHAPTER VII

THE BANK RETURN 56

CHAPTER VIII

PAGE

THE GROWTH OF JOINT-STOCK BANKS . . . 76

CHAPTER IX

JOINT-STOCK BANK BALANCE SHEETS . . 87

CHAPTER X

THE BILL-BROKERS 105

CHAPTER XI

THE CLEARING HOUSE 115

CHAPTER XII

FOREIGN EXCHANGES 122

CHAPTER XIII

THE MONEY ARTICLE OF THE PRESS . . . 144

CHAPTER XIV

CONCLUSION 161

APPENDIX

THE GOLD RESERVE 169

INDEX 179

THE MONEY MARKET

CHAPTER I

THE BEGINNING OF BANKING IN ENGLAND

THE present position of the Money Market in this country so enters into the life of the people as a thing that *is*, that few trouble themselves to inquire how our monetary system came to be what it is, how it was founded, grew, and developed into its present state. Whether people are aware of it or not, the stability and condition of the Money Market of a country influences the lives of all—rich and poor alike—and the material well-being of all is largely dependent upon it. Before proceeding to any examination of the methods in which present-day business in the London Money Market is conducted, we will look back into the past, and trace the rise of our financial system from its early beginnings.

B

Trade is, of course, the foundation of, and reason for, the need of money; and trade commenced with the first division of labour. With the earliest men one was more fitted for one thing and one for another; one was a hunter and one a husbandman. When the hunter handed over to the husbandman so many skins for so much corn, trade was established; but this trade was, of course, only a system of barter. As men grew more civilised and trade developed, the inconveniences of this system became apparent and pressing, and gradually more suitable modes of settling transactions were evolved; although in certain remote and uncivilised parts of the world trading by barter exists to the present day. As a reminder of bygone times there is, in the Royal Exchange, a picture of the Phœnicians trading with the men of Cornwall fine cloth for tin and skins.

We know that the early inhabitants of this country had coinage of a kind, but the earliest record of any definite business in monetary transactions was in the reign of William the Conqueror, who first introduced Jewish traders to this country. From that time on, for hundreds of years, the Jews were more or less intimately connected with our finances; but they led a very chequered career in England, being frequently treated with great cruelty

and barbarity. They were required for the help which could be obtained from them, but hated by the people for their usurious practices. The exactions which the kings and nobles of the time put upon them were largely conducive to these practices, however, as unless the Jews could make large profits out of the people they would not have been able to meet these exactions.

The financial importance of the Jews appears to have declined in this country towards the end of the thirteenth century; but about the same time their place was taken by the Lombards, the early Italian merchants, who came over and settled here in the street which still bears their name. These Lombards were men of some attainment, being skilled in arts and trade, and they possessed the only knowledge of banking then in existence. They combined the art of the goldsmith with the business of the banker, and gradually obtained a firm and sound footing in the country.

The reign of Elizabeth was notable, among many other things, for a great and important increase in the trade and commerce of the country. Many causes contributed to this, among others being the capture of Antwerp by the Duke of Parma, when it is said a third of the merchants of that flourishing city found

a refuge on the banks of the Thames. The newly awakened national energies found fresh outlets and markets, and London gradually became the general mart of Europe and of the then known world. That the knowledge of banking and the foreign exchanges had by this time considerably developed we can gather from many sources; but the knowledge and wisdom exhibited by Sir Thomas Gresham during the reigns of Edward VI., Mary, and Elizabeth is remarkable, and his influence had a far-reaching effect on the public and private finances of the time.

In spite of this increase of the knowledge of monetary matters, however, no settled banking business developed for some time. As our merchants gradually accumulated riches they fell into the custom of sending their surplus funds to the Tower of London for safe custody. This custom was brought to an abrupt end in 1640 by Charles I. taking possession of £200,000 which had thus been lodged at the Tower; but this sum was shortly after repaid. For a time the merchants kept their moneys in their own possession, but owing to the unsettled condition of affairs ruling through the whole period of the civil war, they adopted a system of depositing their cash with the goldsmiths, who were by this time a wealthy and responsible body.

In addition to the presumed safety of funds so deposited, the goldsmiths offered an extra inducement for further funds to be placed in their hands by allowing interest on such moneys. With this additional borrowed cash at their disposal, the goldsmiths commenced the business of discounting bills and lending money; and they also lent money to the king on the security of the taxes. The receipts they issued for the money lodged with them circulated from hand to hand, and were known as Goldsmiths' Notes, and these may be considered the first kind of notes issued in England. Scott, in the *Fortunes of Nigel*, makes Heriot to say, "I am a goldsmith, and live by lending money as well as by selling plate."

In 1672, however, this gradually developing banking business received a rude shock. As we have already seen, the goldsmiths, or bankers, of the time lent their money to the king; that is, they deposited their moneys with the Treasury on the security of the revenue, from which they were afterwards reimbursed, obtaining a good rate of interest on their money in the meanwhile. A king or a government, however, can no more live beyond their income without getting into difficulties, than can an individual. The necessities and extravagances of Charles II.

led him to a memorable step when, in the year 1672, he suddenly ordered the Exchequer to be closed, and refused to pay out any of the sums deposited. The amount thus annexed was about £1,300,000, and this drastic measure had the effect of bringing ruin on nearly half of the goldsmiths, and consequently on their clients who had money deposited with them. The injustice of this seizure raised such universal protest that the king agreed to pay interest at the rate of 6 per cent. per annum on the principal sum out of the hereditary excise. This interest was paid until the last year of his reign, and subsequently an arrangement was made by which about one-half the sum owing was allotted to the claimants in the form of stock. This was the real commencement of our National Debt in its present form.

CHAPTER II

FOUNDATION AND GROWTH OF THE BANK OF ENGLAND

IN tracing the history of our financial system we now come to the important event of the establishment of the Bank of England.

About the year 1691 the Government of William and Mary experienced considerable difficulty in raising the necessary funds to prosecute the war with France; but "the hour brings the man." The man on this occasion was William Paterson, a merchant of Scotland, who had been educated for the Church, but had led a varied and adventurous life. The scheme he presented for the consideration of the Government for the relief of the situation was the foundation of a public joint-stock bank; which, in return for certain powers and privileges to be conferred, should advance money to the Government. His scheme, though well received in official circles, produced very great opposition from many classes

of the public, who thought they would be prejudiced by such an institution.

The goldsmiths thought they saw in it the destruction of their business, the money-lenders a reduction in the rates of interest obtainable, certain merchants a reduction of their profits on Government contracts, while the political opponents of the Government and the king saw that the scheme, if efficiently carried out, would naturally strengthen the former and give the latter a firmer position than he occupied at that time; and all these interested parties with one accord joined forces and condemned the scheme.

But in spite of all opposition the Bill establishing the Bank of England was successfully carried through Parliament, and obtained the royal assent on the 25th April, 1694.

The basis of the Bill was that £1,200,000 should be voluntarily subscribed by the public, and that the subscribers should be incorporated into a body, to be known as "The Governor and Company of the Bank of England."

The whole of the sum forming the capital of the Bank was to be lent to the Government, for which the Bank was to receive interest at the rate of 8 per cent. per annum, together with an allowance of

£4,000 per annum for management and expenses; making in all £100,000 per annum. It was also provided that the sum of £300,000 was to be raised by public subscription, for which the contributors were to receive certain terminable annuities.

By its first Charter, which was for ten years only, the Bank of England was not allowed to borrow or owe more than the amount of its capital; which meant that it could issue notes to the extent of its capital and no more. If this amount were exceeded the members were liable for such excess, in their private capacities, in proportion to their holding of stock.

The capital of the Bank was subscribed in a few days, and when duly paid up, the agreed sum of £1,200,000 was handed in to the Exchequer.

Such in brief was the foundation of the Bank of England, and though its establishment quickly had a beneficial effect on the community at large, in curtailing the ruling rates of interest, yet its early years were marked by great trouble and many vicissitudes. Certain persons who had opposed its establishment from personal motives saw some of their worst fears being realised in the reduction of their profits, and they were not slow to take advantage of every opportunity which presented itself to

throw obstacles in the path of their young though powerful rival, and to unite in efforts to thwart its progress.

With a Government always wanting more financial help, in season and out of season, with debased currency, and with enemies on every side, the position of the directors of the Bank was no enviable one; and it was only by great energy, united effort, and perseverance that they were able to keep their heads above water, and struggle on until at last they found themselves on safer and firmer ground.

The Charter originally granted to the Bank was for ten years only, as we have already seen; but this Charter has from time to time been renewed, and also varied—sometimes in favour of the Bank and sometimes curtailing its privileges. The monopoly of joint-stock banking was not granted to the Bank by its first Charter, but this monopoly was practically conferred on it in 1708. The Act passed in that year provides:—

"That during the continuance of the said corporation of the Governor and Company of the Bank of England, it shall not be lawful for any body politic or corporate whatsoever, created or to be created (other than the said Governor and Company of the Bank of England), or for any other persons whatso-

ever, united or to be united in covenants or partnership, *exceeding the number of six persons*, in that part of Great Britain called England, to borrow, owe, or take up any sum or sums of money on their bills or notes, payable at demand, or at a less time than six months from the borrowing thereof."

In spite of its many embarrassments, the following extract from the *London Magazine* of 1737 shows how well the Bank of England had come to be thought of by that time:—

"There certainly never was a body of men that contributed more to the public safety than the Bank of England. This flourishing and opulent company have, upon every emergency, always cheerfully and readily supplied the necessities of the nation, so that there never have been any difficulties — any embarrassments — any delays in raising the money which has been granted by Parliament for the service of the public; and it may very truly be said that they have, in very many important conjunctures, relieved the nation out of the greatest difficulties, if not absolutely saved it from ruin."

We pass on now to the end of the eighteenth century, when the country was plunged in the throes of war and financial difficulty. Up to this time the Bank, since its foundation, had succeeded in meeting

its notes when presented; but in the year 1796 a steady drain on the reserve of the Bank commenced, owing to the fear of invasion. This drain began to assume a very serious aspect in the early part of 1797, and it appeared probable that the Bank would be subjected to the danger and humiliation of a temporary stoppage. The directors, fully aware of this danger ahead of them, laid the position before the Government, and left the solution of the difficulty in its hands. After due consideration, an Order in Council was issued on the 26th February, 1797, requiring the Bank *not* to pay its notes in gold. On the following day this Order was made public, and the Bank issued the following notice:—

"BANK OF ENGLAND, *February 27th*, 1797.

"In consequence of an order of His Majesty's Privy Council, notified to the Bank last night, a copy of which is hereunto annexed, the governor, deputy-governor, and directors of the Bank of England think it their duty to inform the proprietors of the bank stock, as well as the public at large, that the general concerns of the Bank are in the most affluent and prosperous situation, and such as to preclude every doubt as to the security of its notes. The directors mean to continue their usual discounts for the accommodation of the commercial interest, paying the

amount in bank-notes, and the dividend warrants will be paid in the same manner."

This suspension of cash payments was a very drastic measure to take; but the public, recognising the difficulties of the situation, and appreciating the means which were being taken for the general safety, at once fell in with the spirit of the Order, and a meeting of merchants and bankers was held and passed the following resolution, which received very general support :—

"That we, the undersigned, being highly sensible how necessary the preservation of public credit is at this time, do most readily declare that we will not refuse to receive bank-notes in payment of any sum of money to be paid to us, and we will use our utmost endeavours to make all our payments in the same manner."

An Act was passed in the following May, confirming the action of the Privy Council, but authorising the Bank to pay out sums under twenty shillings in cash, and also allowing certain bankers to have a stated amount of cash. This Act restricted the payment of cash for a period of fifty-two days only, but before it expired a further Act was passed extending the period of restriction, and subsequently other Acts

were passed greatly prolonging the period; and it was not until 1823 that the restriction was entirely withdrawn, although as a matter of fact the Bank really resumed paying in cash on demand on May 1st, 1821, deeming it then safe to do so.

Although a period of safety and prosperity then appeared to have dawned, the Bank was not quite clear of its troubles. The very prosperity of the times led imperceptibly to another period of distress and danger, culminating in the panic of 1825.

The year 1824 was notable for a very great increase in the number of joint-stock companies which were promoted or suggested, and also of loans to foreign countries; and a period of intense excitement and speculation ensued. This was followed by the inevitable crisis, which developed into a panic at the end of 1825, when a large number of London and country bankers had to stop payment. The reserve of the Bank was reduced to a merely nominal figure, and the Bank authorities themselves suggested that they should again be "restricted" as to payments; but the suggestion was firmly resisted by the Government. Fortunately, at the lucky moment, an old box which had been stored away was remembered. It contained a large quantity of £1 notes, and these the Bank at once commenced to issue. This issue

had very quick and beneficial results. The notes were readily received by the public in exchange for the notes of private bankers, the demand for bullion ceased; and Mr. Harman, giving his evidence before a parliamentary committee inquiring into the causes of the panic, stated it was his opinion that this issue of small notes "saved the credit of the country."

In 1826 the Bank of England, by arrangement with the Government, agreed to establish branches in various parts of the country, and gave up their monopoly of joint-stock banking, except within a radius of sixty-five miles of London.

The year 1833, however, saw a further restriction in the powers of the Bank, when, after protracted negotiations, and in return for a further renewal of its Charter, the Bank surrendered its monopoly of joint-stock banking entirely, provided that no bank having more than six partners might issue notes within the sixty-five-mile limit of London.

It is a curious point that the Charter of the Bank never did restrict joint-stock banking in its present accepted form, but only *the issue of notes* by joint-stock bankers or banks having more than six partners. Up to this time the issue of notes by a bank had been thought to be its main business; so much so, that it was believed to be useless to attempt to

conduct a bank without power of issue, and consequently no joint-stock bank had been founded. But about this time the need of such institutions began to be felt, and the presumed monopoly of the Bank of England was called in question—largely by Mr. Gilbart, the founder of the London and Westminster Bank. The Bank tried to assert their monopoly, but without success, and in order to settle the matter effectually, the following clause was inserted in the Act passed in 1833 dealing with the Bank Charter:—

"Be it therefore declared and enacted, that any body politic or corporate, or society, or company, or partnership, although consisting of more than six persons, may carry on the trade or business of banking in London, or within sixty-five miles thereof, provided that such body politic or corporate, or society, or company, or partnership, do not borrow, owe, or take up in England, any sum or sums of money on their bills or notes payable on demand, or at any less time than six months from the borrowing thereof, during the continuance of the privileges granted by this Act to the said Governor and Company of the Bank of England."

It may be noted that this Act of 1833 constituted Bank of England notes a legal tender, except by the Bank itself or its branches.

When the Bank of England first commenced business in 1694, it was located in the Hall of the Grocers' Company, in which building it continued to conduct its operations until the year 1732. A slight dispute then arising with the Grocers' Company as to a renewal of the lease of their hall, it was decided by the authorities of the Bank to acquire a building of their own. Accordingly premises were obtained in Threadneedle Street upon a portion of the present site, and Lawson in his *History of the Bank of England* gives the following details as to the same :—

"The original extent of the Bank comprehends the site of the house and garden belonging to Sir J. Houblon, one of the first directors. It was a comparatively small building, invisible from the street, and surrounded by other buildings, one being the church of St. Christopher le Stocks, and the others consisting of five inns and twenty private houses. As the business and importance of the Bank grew, the surrounding premises were acquired from time to time and demolished, and the present building was gradually erected. Although the church of St. Christopher shared a similar fate with the surrounding buildings, the churchyard was preserved, and now forms what is known as the 'Garden' of the Bank."

Lawson states that one of the clerks of the Bank,

of the name of Jenkins, was buried in this consecrated ground. The cause of this interment in such a place arose out of a fear, as expressed by his relatives, that in consequence of his singular height (he was about seven feet tall), his body would be exhumed by body-snatchers if buried elsewhere. The sequel to this episode is within the writer's personal knowledge. Having to pay a visit to a dentist some few years ago, he was shown, as a curiosity, an enormous human lower jaw-bone with a full set of perfect teeth. Judging from its size, the dentist said that it had evidently belonged to a giant, and he added that it had been given to him by a friend who was a builder and contractor, and that the jaw-bone had been found by one of this friend's workmen while carrying out some alterations and excavations at the Bank of England!

Alas, poor Jenkins! to be buried in the "Garden" of the Bank of England as a sure place of refuge against body-snatchers, and in the end to have his jaw-bone exhibited as a curio in a dentist's surgery.

Having shortly sketched the history of the Bank of England from its inception to the time when it was to be opposed by strong competitive establishments, we now will briefly examine the development of private banking up to this period.

CHAPTER III

THE EARLY PRIVATE BANKERS

WE have already seen that elementary banking operations in the country were carried on by the Jews, who in course of time were succeeded by the Lombards, and that then the business, such as it was, drifted into the hands of the goldsmiths. During the more settled years of the Commonwealth the need of banking accommodation was keenly felt by merchants and traders to enable them to carry on their business, and as demand creates supply, the goldsmith bankers increased in number—and in wealth.

There was, indeed, at this time a demand made by certain persons for the establishment of joint-stock banks, on the system already in vogue in several parts of the Continent; and we find that an eminent London merchant, named Lamb, presented an address to the Lord Protector with this object in view. After enumerating all the advantages to be derived from

the establishment of such institutions, his address concluded in the following quaint form :—

"Lastly, a bank with a certain number of sufficient men of estate and credit, joined together in a joynt stock, being as it were the general cashkeepers or treasurers of the place where they are settled, and divers others, tending much to the tranquility of your highness and the welfare of the English nation, which, with your highness's favourable encouragement, I shall in all humility be ready to make known to you, and remove any objections as can be alledged in the premises, and propound a way how it may be effected, and the evils remedied and prevented, being unwilling to bury the talent in a napkin which it hath pleased the Giver of all blessings in his great goodness and mercie to bestow upon me, hoping that I shall not offend by tendering this with my best services to your highness."

Although this matter was referred to a Parliamentary Committee, nothing came of the proposal.

In 1667 the gradually developing banking business received a check by what is known as a "run" taking place, and this appears to be the first episode of the kind of which we have any record. This event lessened the credit of the bankers, but the action of Charles II. in closing the Exchequer in 1672 nearly brought their business to an end.

By the time of the establishment of the Bank of England, however, many bankers had again regained a position of credit and wealth, and they continued to carry on and develop their business in spite of the competition of the new bank. About the same time several joint-stock banks were founded and carried on successfully until they were obliged to wind up their affairs in 1708, in consequence of the monopoly granted to the Bank of England in that year. Although the London banks, which continued in existence after the granting of this monopoly, were not prohibited by the Bank Charter from issuing their own notes, yet this part of their business gradually declined in the presence of their all-powerful rival, and it ceased altogether about the year 1750 (though some writers give the date as about 1793).

About the year 1775 the City bankers, finding great inconvenience in settling their mutual transactions, established what is called the "Clearing House," to facilitate their exchanges with each other; of this we shall have more to say later. It may be noted that the two oldest banking houses in London are those of Messrs. Child and Company and Messrs. Hoare, both of which were established before the Bank of England.

In the early days of which we are now speaking, the

personal relations of banker and customer were rather different from those of the present time of keen competition: only the merchants and wholesale dealers were personally known to their banker, who was scarcely acquainted with even the names of the retail dealers favouring him with their patronage.

The following amusing anecdote is related, bearing on the lighter side of banking, of an interview between a certain banker in Lombard Street and one of his customers who was a baker:—The baker having one day paid in £500 to his account, left the bank and stood on the doorstep debating in his mind which way he should turn, when the banker came up, and as there was no room for him to pass in without soiling his clothes against the baker's working ones, he haughtily said, "Move away, fellow!" The baker, feeling of some importance, was naturally nettled, and replied somewhat rudely, which led to high words, and finally the banker was sent spinning into the gutter. Rising up full of wrath, he loudly called for someone to fetch a constable and arrest the fellow, when the cashier who had just received the baker's money came forward and, to the banker's surprise, whispered in his ear that the baker was one of his own customers. Retiring into his private room to recover himself, he soon sent for the baker. Apo-

logies were exchanged, and it is said that the banker and baker were thereafter good friends.

Of the early history of country banks we have no very definite records, but we know that after the passing of the Act in 1708, prohibiting the foundation of banks having more than six partners,* a large number of private banks having fewer partners than the prescribed number came into existence to meet the necessities of the time; and after the passing of the Bank Restriction Act in 1797 their number was largely increased. At the time of the passing of this latter Act, it is calculated that there were somewhat under three hundred country banks in existence, but by 1813 we find that the number had increased to nearly one thousand.

In the eighteenth century banking was essentially *free*, in the fullest sense of the word, except for the one prohibition as to the number of partners constituting a bank. Anyone was at liberty to put up the magic word "Bank" over his door and commence business. We cannot say very much as to the solv-

* Under the Companies Act, 1862 (25 & 26 Vict. cap. 89), private banks may now have as many as ten partners. Section 4 provides that "no company, association, or partnership consisting of more than ten persons shall be formed, after the commencement of this Act, for the purpose of carrying on the business of Banking unless it is registered as a company under this Act or is formed in pursuance of some other Act of Parliament or of Letters Patent." Re-enacted by Companies (Consolidation) Act, 1908, sec. 1 (1).

ency of these banks; some were doubtless sound and ably managed, but every wave of distress which swept over the country unfailingly overthrew large numbers of these so-called banks, and occasioned much local suffering.

The gradual evolution of country shopkeepers into country bankers, which was the usual course of the foundation of such institutions in the days of which we are speaking, is well exemplified in the following case, which is related in Lawson's *History of Banking*:—

"In a borough town of importance in one of the north midland counties dwelt a respectable draper, possessing a good connection with the farmers frequenting the market of the town. Although the name of Robin Hood had long lost its terrors, those of Turpin and Nevison filled all men's minds with fear—and with good reason, for they and their fraternity exercised their calling with such energy and success that it was always a matter of doubt with travellers whether or not they should arrive in safety at the next inn or their destination, whatever that might be. With the farmers above alluded to there were more than ordinary grounds of alarm; the town almost adjoining the scene of the far-famed exploits of Robin Hood and his merry men, was admirably situated for a levy by their less romantic successors

of extemporaneous taxes. To avoid as much as possible the losses thus arising, farmers, having full confidence in the honesty of the draper with whom they dealt, made him the depositary of their ready cash. Ready cash of his friends was to our draper as valuable as capital of his own, and buying for ready money was profitable. Still, money remained idle in his hands, and by degrees he began to grant accommodation to his neighbours. Our draper now became famous for his extraordinary command of money, and his correspondence extended as far as Preston, in Lancashire. The profits thus arising seemed boundless, and the next step was taken by our adventurous shopkeeper: he allowed a small interest to his friends the depositors. The new business flourished to such an extent that it swallowed up the old one, and our draper at length became a *banker proper*, and no more a shopkeeper.

"Such was the origin of the Smiths. First confined to the town of Nottingham, afterwards extended to Hull and Lincoln, the business of the firm required a London correspondent entirely in their interest, and such they found in the late Mr. Payne."

And thus was founded the well-known firm of Smith, Payne, and Smith, whose business has recently been amalgamated with that of the Union Bank of London.

Many are the tales told of the wit and shrewdness of the early country bankers, and the following anecdote, related in Mr. Maberley Phillips's interesting work on *Banks, Bankers, and Banking, in Northumberland, Durham, and North Yorkshire*, is on a par with the well-known tale of the private Irish banker, who became so very unpopular, that to show the contempt in which he was held, the inhabitants of his district gathered together all his notes which they could lay hands on, and made a bonfire of them in front of his house; much to the banker's amusement and gain.

Mr. Phillips's story is of Jonathan Backhouse, a Quaker, who, though originally a linen and worsted manufacturer in Darlington, founded "Backhouse's Bank" in 1774, in partnership with his father. This institution only went out of existence in 1896, when it was amalgamated with Messrs. Barclay and Company, Limited.

"Before the time of railways, near the beginning of the century, the commercial traveller of that day made his visits to the towns of the county of Durham either by mail coach or other conveyance, and sojourned for some days in each town, where he was an important person, especially at the head hotel or hostelry of the place. It so happened that one of

these gentlemen, after having dined freely at the 'King's Head,' Barnard Castle, was boasting to a company present in the commercial room of his own importance and wealth, and exhibiting in proof a sheaf of bank-notes taken on his journey.

"Jonathan Backhouse, attired in the usual dress of the Society of Friends, unknown to the rest of the company, was in the room quietly reading his newspaper, when he was attacked by the wealthy commercial, and by a series of sarcastic remarks held up to ridicule as a man out of harmony with the spirit of the time and place. Following up this raillery the commercial, displaying his handful of notes, offered to bet the Quaker £5, or any sum, that he could not produce as much money as he was exhibiting. Mr. Backhouse, after a great deal of banter, said *he did not bet*, but to show his indifference to money offered to put a £5 note in the fire if the commercial would do the same. Suiting the action to the word, Mr. Backhouse took out a £5 note and put it into the fire. The commercial, not wishing to be behind, did the same. Mr. Backhouse offered to repeat the process, but the commercial, considerably cowed, declined; when Mr. Backhouse quietly thanked him for having burned one of his (Mr. Backhouse's) bank-notes for which he had received £5, while the note he (Mr. Backhouse) had burned was on his own bank, and only cost him the paper."

CHAPTER IV

THE BANK CHARTER ACT OF 1844, AND ITS SUSPENSIONS

AFTER the renewal of the Charter in 1833, the directors of the Bank of England laid down as a principle on which their future operations were to be guided, that one-third of their liabilities should be kept in cash and bullion, and the remaining two-thirds in securities. If this principle had been acted on, the Bank would have been saved from many of the troubles which shortly assailed it; but though the intentions of the directors were good, circumstances were too strong for them, and the actual proportions of cash and securities to liabilities respectively, often differed materially from the standard laid down. This was notably the case during the periods of financial pressure which were experienced in the years 1836 and 1837.

In the year 1839 matters assumed a very serious

aspect. In the early part of this year the amount of cash held by the Bank was about one-third of the amount of securities, but during the year the amount invested in securities increased at the expense of the amount held in cash; and by September we find that securities stood at nearly £29,900,000, while the cash was reduced to a tenth of that figure, and stood at £2,936,000 only. In order to avert a calamity which appeared to be impending, the Bank arranged loans in Paris and Hamburg to the extent of between three and four millions.

This manifest exhibition of weakness on the part of the Bank led to the appointment of a committee of the House of Commons to inquire into the matter. The committee condemned the principles on which the Bank was working, but were powerless to effect any alteration, owing to the Charter of the Bank not expiring till 1844.

On the expiry of the Charter, however, Sir Robert Peel brought forward his famous Act for remodelling the Bank, and regulating the issues of the country banks throughout England and Wales.

The Act was passed on the 19th July, 1844, and continues without alteration to the present day. The main provisions enacted thereby, briefly stated, are as follows:—

I. The Issue Department and the ordinary Banking Department of the Bank of England were to be entirely separated as from the 31st August, 1844.

II. On such separation taking place, securities to the value of £14,000,000 (including the debt due to the Bank from the Government) were to be transferred to the Issue Department, together with so much gold coin and bullion that the total so transferred should equal the total amount of notes then outstanding. Thereafter (with the exception noted below) the Issue Department must not issue any notes in excess of a total of £14,000,000 except in exchange for gold coin or bullion.

III. The Issue Department might not at any time hold more silver than one-fourth part of the gold held. As a matter of fact, the Issue Department holds no silver.

IV. Notes might be demanded from the Issue Department by any person in exchange for gold at the rate of £3 17*s.* 9*d.* per standard ounce.

V. If any banker having the power of issue on the 6th May, 1844, should relinquish such issue, the Issue Department may be authorised to increase its issue of notes against securities to the extent of two-thirds of the issue so relinquished; but all the profits on

such increased issue against securities were to belong to the Government.

VI. The Bank must issue a weekly statement of the position of both its Issue and Banking Departments, in a prescribed form.

VII. Bankers having the right to issue their own notes on the 6th May, 1844, might continue such issue under certain conditions, and to an agreed amount; but no provision was made compelling such bankers to keep any reserve either in cash or securities against their issues. If any issue lapsed, from any cause, it could not be resuscitated; and no institutions could acquire the right of issue in the future.

VIII. Banks consisting of more than six partners, though within the sixty-five-mile radius of London, might draw, accept, or endorse bills of exchange not being payable to bearer on demand.

The first return issued by the Bank in accordance with the regulations of the new Act was that of the 7th September, 1844, and was as follows:—

ACCOUNT OF THE LIABILITIES AND ASSETS OF THE BANK OF ENGLAND

For the Week ending 7th September, 1844

Dr. ISSUE DEPARTMENT *Cr.*

	£		£
Notes issued .	28,351,295	Government debt	11,015,100
		Other securities .	2,984,900
		Gold coin and bullion . .	12,657,208
		Silver bullion .	1,694,087
	£28,351,295		£28,351,295

Dr. BANKING DEPARTMENT *Cr.*

	£		£
Proprietors' capital	14,553,000	Government securities . .	14,554,834
Rest . . .	3,564,729	Other securities .	7,835,616
Public deposits .	3,630,809	Notes . .	8,175,025
Other deposits .	8,644,348	Gold and silver coin	857,765
Seven-day and other bills . .	1,030,354		
	£31,423,240		£31,423,240

For comparison we append the Return of the 2nd September, 1903.

Dr. ISSUE DEPARTMENT Cr.

	£		£
Notes issued .	51,831,835	Government debt ,	11,015,100
		Other securities .	7,434,900
		Gold coin and bullion . .	33,381,835
		Silver bullion .	Nil
	31,835		£51,831,835

Dr. BANKING DEPARTMENT Cr.

			£
Proprietors' capital	14,553,000	Government securities . . .	18,260,841
Rest	3,740,209	Other securities .	24,969,260
Public deposits .	7,393,580	Notes . . .	22,322,875
Other deposits .	41,872,061	Gold and silver coin	2,119,339
Seven-day and other bills . .	113,465		
	£67,672,315		£67,672,315

The provisions of the 1844 Act, above noted, are the principal ones which affected banking in general, and the Bank of England in particular—they were the food for much debate and discussion before they became law, and it may be added that several of the provisions then enacted have been the food for much debate and discussion ever since. Taken as a whole the Act has worked well, and has succeeded, in combination with greater knowledge and foresight, in maintaining our banking system in a sound condition.

The regulations as to the country bank-note issues were framed with the idea of ultimately eliminating entirely such issues; but though the amount of private notes in circulation has decreased, and also the number of bankers who have the power of issue —by lapses, bankruptcy, and amalgamations—the time when there are no country bank-notes has not arrived, notwithstanding that the framers of the Act confidently anticipated that such a result would be achieved long before now.

The main point of contention between the supporters and opponents of the Act lies in its want of elasticity in time of need. Under no circumstances can the Bank increase its issue of notes against securities beyond the prescribed limit, without a breach of the law; but on three occasions in the past the law has been broken, though with the consent of the Government, and subsequent confirmation of Parliament.

Under the laws regulating the Imperial Bank of Germany such procedure would not have been necessary. The German Bank Law has been framed largely on the same lines as our own, but it gives the Reichsbank power to increase the amount of notes issued against securities on a payment to the Government of a fine of 5 per cent. per annum on the

excess issue. This fine is sufficient in ordinary times to act as a complete check on overissue, but in times of trouble it acts as an efficient safety-valve by relieving the minds of business people from the fear that "there will not be enough to go round." If it is known that money can always be had at a price, the probability of a crisis developing into a panic is almost entirely obviated.

We will now briefly review the three occasions on which the Bank Act was suspended, and the effect of such suspensions.

The first of these occasions was during the panic in the year 1847—known as the "railway panic." Shortly previous to this year a great accumulation of capital had led to a demand for new investments, which were duly provided for the public by those concerned with such matters. Added to this, interest rates had ruled low for some time, and this conduced to a period of speculative activity. Too much capital was put into fixed investments—chiefly railways—and in one session of Parliament sanction was asked for various railway schemes involving a total capital of £340,000,000. Wild gambling in railway stocks ensued, credit was inflated above all reason, and then the turn came. This was primarily due to a bad harvest and potato crop causing a

heavy importation of corn, and consequent export of gold.

During the panic which ensued, the reserve of the Bank of England fell to £1,600,000, but when the panic was at its height, the Act, passed only three years before, was suspended. The Bank was authorised to increase its accommodation to the public by exceeding, to an indefinite extent, the limit fixed for the issue of notes not secured against gold. The effect of this suspension of the Act was immediate and complete. The fear that "there was not enough to go round" passed from men's minds. As a matter of fact, the issue on this occasion did not exceed the normal limit, the mere knowledge that the Bank was empowered to exceed this limit proving sufficient to allay the panic.

The second suspension of the Bank Act was due to the crisis of 1857, a crisis that was brought about by reckless overtrading, and came upon the public very suddenly and with practically no warning. The reserve of the Bank of England had been allowed to fall dangerously low during the course of the year, and large financial operators had carried on vast transactions with hardly any capital—only credit—relying for assistance on the Bank. Bad news came to hand from America in September,

detailing how there had been a serious financial collapse in that country,; failures had occurred, shaking commercial credit to its core, and about one hundred and fifty banks had stopped payment.

A heavy drain of gold from here to America commenced, and by the middle of October credit was curtailed, and distrust was rife in England. Within a very short space of time many of our banks and financial houses were crippled and failed. In November heavy demands were made for gold for Scotland and Ireland, and on the 11th November the failure of Sanderson and Company—a great London discount house—was announced, with liabilities of upwards of five millions. Utter rottenness appeared to pervade the commercial world, and general bankruptcy seemed imminent, when for the second time the Bank Act was suspended. This took place on the 12th November, and at once had the effect of quieting the public mind. On this occasion the Bank had to make use to a large extent of its temporary authority to issue notes above the normal limit without holding gold against them. The severity of this crisis can be seen by the fact that in November the Bank reserve fell to under £600,000, while the bankers' balances at the Bank of England alone stood at about five and a half millions, and

the Bank Rate was as high as 10 per cent. This was also the rate charged by the Bank of France at the time, showing that the panic had spread, and was not solely confined to ourselves and America.

The third suspension of the Bank Act took place in 1866. Many elements of disturbance to the Money Market had been in force during two or three preceding years. The Civil War in America had resulted in gold being sent to this country; but the stoppage of the supply of cotton from America, owing to the war, disorganised one of our staple national industries, and supplies of cotton had to be obtained from elsewhere at high prices, and paid for in cash. Hence a drain of gold set in on a large scale. In addition, a large speculation had been built up on credit in the stocks and shares of the many new limited liability companies which were formed at that time.

General uneasiness began to prevail towards the end of 1865; in January, 1866, the Bank raised its discount rate to 8 per cent., and a crisis began to develop rapidly.

Speculators tried to sell their securities and found no market for them, several large railway contractors failed, and many of the newly formed limited liability companies succumbed and were wound up. The

failure of the Joint Stock Discount Company, followed shortly by that of Barned's Bank of Liverpool, brought matters to a head; the distrust became universal and culminated in panic. On the 9th May the Bank Rate was raised to 9 per cent. On the 10th May the failure of Overend, Gurney, and Company—for upwards of ten millions—was announced, and the Bank Rate went to 10 per cent. This failure was not made known till after business hours, so it was not till Friday, the 11th May, 1866—known as "Black Friday"—that the crisis reached its height.

The stoppage of this large house affected the whole world, and general failure seemed imminent, when, in the afternoon of the day on which the failure became known, it was announced that the Bank Act was again suspended, and calm began to take the place of mania. But though the panic was allayed, many failures shortly took place, which delayed the quick restoration of a sense of security. Among these failures may be mentioned the Bank of London, the Consolidated Bank, and Agra and Masterman's Bank. All these three institutions were perfectly solvent as a matter of fact, but they found themselves in the dangerous position of having no *available* assets. The two last-named banks subsequently resumed business.

From the above brief records of the financial tragedies of the past, we see that on each occasion reckless speculation and overtrading had been allowed to reach a dangerous height before any steps were taken to check them, and on each occasion the check came too late. But we also see the marvellously quick effect which the suspension of the Act had on the situation. Although a period of nearly half a century has elapsed since the time of the last suspension, the position remains the same, and it is only owing to greater knowledge and greater caution that such catastrophes have been averted.

In contemplating any future catastrophe of the kind which may come upon us, it is generally assumed that the Act would be again suspended; but delays are dangerous. By the time the situation had developed to such an extent that the Government might deem it expedient to give the Bank the necessary powers, a panic such as has never before been known might overtake us; whereas if the suspension of the Act were to a certain extent automatic, and responsible people knew for certain that money could always be had at a price, the probability of such a termination of any crisis would be very remote.

CHAPTER V

THE DEVELOPMENT OF LONDON AS THE FINANCIAL CENTRE OF THE WORLD

BEFORE proceeding to examine the Money Market and banking system of more modern days, it will be well to glance at the causes which contributed to the predominance of London among international financial centres, and made it the clearing house of the world. At the present time this predominance is being assailed from several quarters —notably Paris, Berlin, and New York—but there is no doubt that London still holds a good lead, and with knowledge, activity, and perseverance there appears to be no reason why it should not continue to be in the forefront in the future.

In the *Wealth of Nations* Adam Smith points out that the increase and riches of commercial and manufacturing towns contribute to the improvement and cultivation of the countries to which they belong, and that commerce and manufacture introduce order

and good government, and with them the liberty and security of individuals.

In our own history we can trace the truth of these remarks. We have already drawn attention to the flourishing state of trade which developed during the reign of Elizabeth. New industries were started, villages grew into towns, and new markets for our wares were opened up in various parts of the then known world. In consequence of the wars on the Continent, many wealthy merchants came or were exiled to our shores, and settling here, helped to swell the growing business of London. We were fortunate in the fact that this "greater liberty and security of individuals," enabling our forefathers to devote their attention and wealth to the further development and expansion of the commerce of the country, came about with us long before a similar state of affairs began to have effect with our continental neighbours, and this gave us a good start commercially. While our neighbours were still in the throes of continual disputes and unrest, we were laying the foundations of a world-wide system of trade. We were in a position to supply the Continent with their various needs as they arose, to our own immediate benefit and the further advancement of our commerce.

In connection with the more rapid development of commerce with us than with continental nations must be remembered the energy and activity of the race forming the population of our country—an energy and activity not only in starting and conducting new industries, but in spreading abroad to new lands and forming new colonies, thus enlarging the sphere of our operations and the number of our markets.

Our geographical position has assisted materially in our commercial development. The disturbances arising from the fear and risk of invasion have been less pronounced than with continental nations, and our extended coast-line, embracing many natural shelters, has engendered our vast shipping industry, without which we could never have attained to our present position. We have also had the advantage of another natural circumstance in the proximity of our coal and iron fields to each other. This gave us for a long period an unparalleled command of certain trades dependent on this fact. Thus we see that, owing to good government, national character, and natural conditions, our trade was built up on a firm foundation, and was spread abroad until its ramifications extended into every country of the world.

Turning now from the trade point of view to the

monetary position, we find that as our trade grew, so did our means and capacity of dealing with that trade. Although in early days we were rather backward in our banking system, yet that system developed quicker with us than with other countries. The eighteenth century embraced many periods of financial distress, but the Government never defaulted in any of its engagements, and our leading merchants became renowned as men of honour and integrity. During the early part of the nineteenth century our position improved by leaps and bounds, our gold standard of currency was firmly established, our merchants' names became known and honoured throughout the world, and direct financial operations between London and all foreign parts became matters of daily occurrence.

These monetary transactions were very essential in the financial growth of London, and were a large factor in our capital becoming the centre of finance. Owing to the vast extent of our trade, both as to its amount and diffusion, we were in a position to conduct financial transactions the world over. From this it followed that when commerce began to expand and grow among continental nations, it was found that the easiest way of settling the financial business arising therefrom was through the inter-

mediary of London. England bought from and sold to all nations, but in the first half of the nineteenth century *reciprocal* transactions between foreign centres of trade were few and far between. For instance, suppose a New York merchant shipped produce to Hamburg, he would draw on some appointed London house for payment; the merchant in Hamburg who had bought the goods would then have to find the means of providing this London house with the necessary funds to meet the draft from New York. This he would do by buying a draft in Hamburg from some merchant there who had shipped goods to London and was wanting payment. This draft he would remit to the London house on which the American exporter had drawn, and the London house would collect the money represented by the Hamburg draft, thus settling both transactions. This is only a rough example, but it is typical of what came to be a regular custom.

Various countries may trade together, but unless they have direct mutual financial transactions, they cannot settle their indebtedness without remitting precious metal of one kind or another, or employing the agency of another country which has direct financial dealings with both. In the time of which we are speaking London was the only centre which

was in a position to carry out such transactions. In the latter half of the past century, and especially towards the close of the century, our position suffered through direct financial operations between various countries becoming established, thus eliminating the need of a middleman; but it may still be said of London that it has direct financial and trading connection with *every country of the world*, which at present cannot be said of either Paris, Berlin, or New York. The very fact of the establishment in London of branches of the leading banks and finance houses of France, Germany, and the United States, emphasises the position which London has attained and still holds in the financial world.

CHAPTER VI

FACTORS OF THE MONEY MARKET

HAVING now surveyed the history and development of our financial system up to a point when "system" can really be said to have started, and also having glanced at the causes which have placed London in the forefront of all financial centres, we will consider the formation, as a whole, of what is called the "Money Market"; and then more carefully examine certain of the more important factors which help to form that market.

There is no definite "market" for money in the sense of a "place of purchase and sale," like a cattle market or a corn market; when we speak of the "Money Market" we refer to the body or aggregation of large dealers in money—bankers, bill-brokers, etc.—who either have money to lend or who require to borrow money, and by whom the rate to be charged for the use of money is largely settled, as a result of their mutual transactions.

This body of money-dealers is not clearly defined into two classes—lenders and borrowers—as an ordinary market is divided into two classes—buyers and sellers; but with money-dealers all are practically both buyers and sellers; that is, all are ready to sell the use of money at a certain price, and to buy the use of money at another price.

The Bank of England in bygone days was the predominant factor in the Money Market; but now, in ordinary times, it has somewhat fallen from its high estate in that respect. It is only at certain times that its funds find their way into the Money Market to any large extent. But the Bank still has the power, when occasion arises, to make its influence predominate, as it constitutes the final reserve, in case of need, of our banking system. The Bank likewise has the power to make its influence felt when the directors deem it advisable to obtain control of the Money Market, for the purpose of maintaining the monetary position on a basis of safety. As we shall see when dealing with the subject of the foreign exchanges, if, in order to check an outflow of gold, the directors of the Bank wish to raise the value of money in London—that is, to raise the rate at which money can be borrowed or lent—they raise the official rate of the Bank of England. If the out-

side market lags behind, or does not keep in line with the movement, they force it to do so by themselves borrowing large sums from the market, thus reducing the available supply of money in the hands of the market, and consequently enhancing the value of money.

The chief factor in the formation of the Money Market is the body of the joint-stock and private banks of London, and through them of the bankers of the kingdom. Practically all the working capital of the country and the floating money of private individuals, together with moneys awaiting permanent investment, are now in the hands of our bankers.

Of this vast accumulation of capital held by bankers — amounting in the United Kingdom to some £800,000,000—a certain part is retained in actual cash, besides a balance which is kept with the Bank of England or a London agent, some is invested in securities, and the balance is used in lending to those that require the use of further capital for their business or private needs. Of this balance so lent, a large percentage is advanced to individual customers by way of loan, overdraft, or in the discounting of bills; and the remainder is used in the Money Market proper, or what has been aptly called "The Short Loan Fund." The rate of interest which

private individuals have to pay for advances from time to time is largely based on the prevailing official rate of the Bank of England as regards loans, and on the "market rate" as regards the discounting of first-class bills.

For the greater part of the money in a banker's hands no interest whatever is paid, that is, for practically the whole of the current account balances. For the remainder, the money on deposit, only a small interest is paid; but a banker must always keep before him the fact that nearly all his liabilities are repayable in cash on demand. Thus he must *always* keep himself prepared for eventualities, and his first line of defence consists of cash and balance with the Bank of England or London agent, and he reckons his advances to the Money Market as his next most quickly convertible and available asset.

For the money advanced to the Money Market bankers are content to receive a low rate of interest, provided that the advances are absolutely safe, and can quickly be called in when necessary. These conditions can be obtained by lending money at "call" (that is, repayable on demand) or at a few days' notice to the bill-brokers, who, deposit as security for such loans, first-class bills, or certain of the highest class of securities, such as Consols, etc.

The bill-brokers and discount houses of London form the second most important factor in the Money Market. These firms and institutions practically act as middlemen or intermediaries. Many of them possess large capital themselves with which to conduct their business, but the bulk of the funds which they employ consists of borrowed money. This money is borrowed from various sources; the greater part from the banks, some from the India Council, and some from our merchant princes and finance houses, who of themselves really constitute another factor in the Money Market. Besides these sources for borrowing money, the bill-brokers further increase their working funds by receiving money on deposit from the public. With the funds so collected they buy bills, usually only those of a first-class character, and these they either hold until maturity or rediscount with the banks, and occasionally with the Bank of England.

The British Government is at certain times a factor in the Money Market, that is, when on account of any extraordinary outlay, or when expenditure is temporarily exceeding revenue, it issues Treasury Bills and Exchequer Bills. If these bills are bought by the Money Market, it follows that the amount of money in the hands of the Market is, at least for the

time, decreased by the amount of money paid for the bills (which goes into the Bank of England and helps to increase "Public Deposits"), and consequently the rates for money in the open market are inclined to rise or "harden." When these bills are repaid the contrary effect is produced, market supplies are increased and rates are inclined to droop.

Another factor which has to be taken into account in this matter is the India Government. The India Government has, from time to time, large funds lying here which are not required for immediate use, nor are they available to lend for long periods; these funds practically constitute a floating balance. Use is made of this money by lending it out to the market through a well-known house, much in the same manner that banks lend their floating balances. The money is usually lent in sums of not less than £50,000, for periods from a fortnight to a month; and it is generally stipulated that the securities deposited against the advances shall consist of either Consols, or Indian Securities of certain kinds, such as rupee paper and the guaranteed debentures of a few of the first-class Indian railways. The India Government generally manages to obtain a very fair return for the money so lent.

The Stock Exchange is another element which

requires consideration, although it is a rather one-sided element, inasmuch that it is nearly always a borrower. In busy times on the Stock Exchange enormous sums are borrowed from the banks for the purpose of speculation, of one kind or another. Stocks are bought by various persons who have not the money to pay for them, in the anticipation that they will increase in value; and these persons arrange with their brokers to "take up" the stock for them—that is, that the brokers shall find the money to pay for these purchases—and this ultimately results in a banker advancing the money. During periods when the rates of interest are low also, large amounts of stock bearing a higher interest are then "taken up," for the purpose of securing the difference in the amount of the interest paid for the loan and the interest received from the stock, and the money for these purchases is largely borrowed from banks. These Stock Exchange loans are made from "account to account"—that is, from one settling day on the Stock Exchange to the next—and as there are two settling days every month, the loans are nominally granted for about a fortnight each. The interest charged is fixed at the beginning of each account for that account, and varies according to the prevailing conditions at each renewal.

Lastly, we have a somewhat new factor entering into the Money Market, but one which is increasing in importance, and that is the establishment in London of branches of many powerful and rich continental banks, who make use of the London Money Market for employing their surplus funds when they can do so to advantage. They lend money to the bill-brokers much as do ordinary London banks; and at times, when the conditions are favourable, they invest their funds in English bills, occasionally absorbing considerable amounts of Treasury and Exchequer bills. These purchases of English bills increase the money in the market for the time being, and the competition of these foreign bankers tends to depress the rate charged for discount. It must be remembered, however, that this course of business gives the banks in question power to draw gold from us heavily on the maturity of the bills, or at any time when they see fit, by selling their bills before maturity.

From a consideration of these various factors, we see how largely they are interwoven together and dependent on each other. The banks gather in deposits from all quarters and lend to the bill-brokers, while leaving a large amount with the Bank of England; and the bill-brokers borrow from the

banks and buy up bills from all quarters; but if the banks "call" their money from the bill-brokers the latter are driven into the arms of the Bank of England, to reborrow the money which the banks have called from them. This is also the case if the India Government call in their loans, and the money to repay the same cannot be borrowed from the banks. Similarly with the Stock Exchange, if much money is absorbed in this quarter, the banks will reduce their accommodation to the bill-brokers, who may by this action again have to rely on the Bank of England; and again, lastly, if the foreign banks commence to draw money from us, the strain comes as usual on the Bank of England.

All these factors work round the Bank of England as a centre, and the need of strength on the part of that institution becomes at once apparent when it is seen what mighty interests are dependent on it, that the financial credit of the country rests ultimately upon its stability, and that its policy and actions involve consequences of weal or woe to the community at large.

CHAPTER VII

THE BANK RETURN

WE will now examine the weekly "Return" issued by the Bank of England in accordance with the requirements of the Act of 1844, and consider the significance of the various items appearing therein. The Return is made up to the close of business on every Wednesday, and is published on Thursday. Though the figures given always attract attention, and are regularly made the subject of analysis and criticism in the financial articles of the Press, yet the interest taken in the Return varies considerably from time to time. During periods of financial quiescence this interest is somewhat of an academical character; but in times of doubt and distrust a very real and practical interest is exhibited, not only by the group of bankers, bill-brokers, and merchants constituting the "Money Market," but by that section of the general public who have financial transactions at stake, and who possess the requisite

knowledge to understand the true import of the figures of the Return.

For the purpose of our analysis we will take the Return of the 2nd September, 1903.

ISSUE DEPARTMENT

	£		£
Notes issued . .	51,831,835	Government debt	11,015,100
		Other securities .	7,434,900
		Gold coin and bullion . .	33,381,835
	£51,831,835		£51,831,835

BANKING DEPARTMENT

	£		£
Proprietors' capital	14,553,000	Government securities . . .	18,260,841
Rest	3,740,209	Other securities .	24,969,260
Public deposits .	7,393,580	Notes . . .	22,322,875
Other deposits .	41,872,061	Gold and silver coin	2,119,339
Seven-day and other bills . .	113,465		
	£67,672,315		£67,672,315

ISSUE DEPARTMENT

In a previous chapter we saw that under the Act of 1844 the Issue Department was to be separated from the Banking Department, and that it was at liberty to issue £14,000,000 of notes against

securities, of which the Government Debt, amounting to £11,015,100, was to form a part. Any issue of notes above this amount of £14,000,000 was to be secured by an equal amount of coin or bullion, with the proviso, however, that the issue of notes against securities might be increased from time to time to the extent of two-thirds of the amount of any lapsed country issue.

In the return before us we see the result of nearly sixty years of the working of the Act. The notes issued stand at £51,831,835, and are secured by the Government Debt of £11,015,100 (as at the passing of the Act) and other securities amounting to £7,434,900 (against £2,984,900 in 1844), the balance being made up of gold coin and bullion, no silver being now held. We thus see that advantage has been taken of the lapsing of country bank issues to increase the issue against security by £4,450,000; but it must be remembered that the net profit on this additional issue against securities is credited to the public account.

The actual amount of notes issued, as shown in the returns of 1844 and 1903 respectively, as shown on pages 32 and 33, has increased by the sum of £23,480,540; but if we compare what is called the "Active Circulation" now with that of 1844 we see that the increase is only £9,332,690.

The Active Circulation is arrived at by deducting the amount of notes held by the Banking Department from the total of notes issued by the Issue Department, and it represents the notes actually in the hands of the public. This increase in the Active Circulation is a fluctuating one, but at any time it is totally out of proportion to the expansion of our trade and financial system which has taken place during the last fifty years. The comparative insignificance of the increase is explained by the fact that during the period under review our manner of effecting payments has changed so vastly, cheques having almost completely taken the place of notes in settling our various transactions, both in business and private affairs.

The old idea that a note issue was of vital importance to the life of a bank, and that a mere bank of deposit could not be profitably and usefully conducted, was exploded in the early part of last century, as already explained. The new ideas which then began to prevail, and which led to the formation of our joint-stock banks, have expanded and developed in a manner that was probably not anticipated by the banking pioneers, who successfully assailed the Bank's presumed monopoly of joint-stock banking.

In such a manner have these new ideas and methods expanded, that the use of the bank-note

has practically been done away with, except for special reasons and in certain cases.

These exceptions divide themselves into two heads. Firstly, the large number of Bank of England notes held in place of actual coin in the tills of our banks; and secondly, notes used in settling certain transactions when it is not the custom, or it is not convenient, to pass cheques; such as the settlements arising from the purchase of property, travelling expenses, and for effecting payments and purchases with the non-banking class—a class which is diminishing day by day under our present system of banking.

The amount of notes held by bankers as "till money" is of paramount importance in point of amount compared with the amount of notes in circulation for the other purposes mentioned. The average amount held by bankers from time to time usually remains at a fairly steady figure, whereas the amount of notes in the hands of the people varies considerably; increasing at the end of each month on account of salaries paid by notes, at the end of quarter for payment of rents, etc., and largely increasing during the holiday season by reason of notes carried by travellers to the Continent and elsewhere.

As regards the items appearing on the credit side of the Issue Department's weekly balance sheet, the

Government Debt stands at the same figure as at the passing of the Act.

Other Securities have risen in accordance with the provisions of the Act, and are doubtless of a first-class character, although no information is vouchsafed to us as to the actual securities held.

The remaining item of *Gold Coin and Bullion* of course fluctuates with the amount of notes issued; the department is something like an automatic machine in this respect—you put in gold and take out notes, and you put in notes and gold comes out. The Issue Department is not only compelled to issue notes in exchange for sovereigns, but also for gold bullion—in bars or foreign coin—at the rate of £3 17*s*. 9*d*. per ounce of standard fineness. Any bullion the Bank acquires in this manner it is at liberty to send to the Mint and have converted into coin; but as a matter of fact, a large amount is retained in the form in which it is received, that is, in bar gold and foreign coin. If an export of gold is in progress the exporter can, of course, obtain five sovereigns for every £5 note he presents; but it frequently suits his purpose better to draw bar gold or foreign coin in exchange for his notes, and the Bank is at liberty to charge what it likes for so accommodating him. The price usually charged by

the Bank for its bar gold is £3 17*s.* 10½*d.* per ounce, but if the demand is pressing it will raise its price to perhaps £3 17*s.* 11*d.* Above this figure it is not effectual to raise the price, or sovereigns would, in that event, be drawn and melted down. A similar course as regards sale is in vogue for dealing with foreign coins, and the Bank makes a small profit on such transactions.

BANKING DEPARTMENT

Turning now to the return of the Banking Department, the first item which appears is *Proprietors' Capital*, which stands at the enormous figure of £14,553,000—enormous in itself, and enormous in comparison with the capitals of other and competing banks. From the original sum of £1,200,000 with which the Bank commenced business in 1694, the capital has gradually increased until it amounted to the present figure in 1816, since which year there has been no alteration.

The *Rest* in the Bank of England Return is an accumulation of undivided profits, and compares with the Reserve Funds of other banks. It now stands at about the same figure at which it stood in 1844; and it is never reduced below the sum of £3,000,000. The Bank has also a further reserve

in the valuable asset of its premises in the City—the very finest site in London—no credit being taken for the value of this item.

Taking the Proprietors' Capital and Rest together, we see that the Bank has a total working capital of about seventeen and a half millions, which is far above that of any other Bank, both in amount and in proportion to liabilities. This large capital forms, of course, an element of great strength, but the profit which is earned is so spread out on such a sum, that the actual dividend paid is small in comparison with that of many ordinary joint-stock banks. The dividend paid during the last ten years has averaged 9½ per cent., having been at the rate of 10 per cent. since the end of 1896. The price of Bank Stock has fluctuated between 311 and 367 during the same ten years.

Public Deposits include the balances of the Exchequer, Savings Banks, Commissioners of the National Debt, and Dividend Accounts. This is a very variable item, and its fluctuations at certain seasons of the year have a marked effect on the Money Market. On the 14th of January, 1903, Public Deposits stood at just over eight millions, and on the 25th March, 1903, at over sixteen millions, this increase being due to the collection of taxes at this

season of the year, which gradually sweeps away a portion of the balance of other banks, and draws a large sum from the pockets of the people. The increase of the balance of Public Deposits reaches a maximum about the end of March, when the collection of taxes comes to an end.

This gradual accumulation of an extra sum of £8,000,000 in the hands of the Bank of England naturally affects the amount of money which other bankers have at their disposal for lending purposes, and money being thus scarcer, borrowers have to pay more for the use of it. Hence it follows that during this season of the year a tightening of the rates charged by bankers for accommodation is generally seen. After the end of the financial year on the 5th April, the Government generally commences to disperse its large balance by paying its various bills; and this disbursement, together with the dividends on public stock which are paid at the beginning of April, quickly alters the position; money becomes plentiful in the hands of ordinary bankers, and the rates charged for the use of it consequently fall away. From this time on to about the beginning of December, Public Deposits gradually decrease, although there is generally a slight rise at the end of each quarter, followed by a fresh fall immediately

after the quarter, this movement being due to the payment of dividends.

Other Deposits include the balances of the ordinary customers of the Bank, both in London and the country, and also the balances kept by bankers with the Bank of England. The balances of the ordinary customers of the Bank are subject to the same conditions and fluctuations as are the balances of the customers of other banks, but the bankers' balances are of another class. Every "clearing" bank *must* keep an account with the Bank of England, in accordance with the rules of the Clearing House, as will be explained later. Most other London bankers also keep an account there, as well as many country bankers. The aggregate of the bankers' balances forms a large proportion of the "Other Deposits." Up to the year 1877 the total of bankers' balances was stated as a separate item in the Weekly Return, but this practice was discontinued at that time. In the year 1877—the last year of separate publication—these bankers' balances averaged about nine and a half millions, but the amount has doubtless largely increased since that time.

Bankers' balances form, as we shall see, the ultimate reserve on which our banking system rests. Hence the subject is one of great importance. Every

"clearing" banker keeps a balance for the purpose of settling the difference which may arise with each day's settlement at the Clearing House. In addition to this, they, as well as other London and country banks, maintain a large balance at the Bank of England for the purpose of meeting any sudden or extraordinary demands which may be made on them. This is done in place of keeping cash in their tills for the purpose, though of course a sufficient sum in ready cash is kept in hand to meet the ordinary daily requirements. In the case of those country banks which do not keep an account at the Bank of England, the custom is adopted of keeping a reserve balance with a London agent. This reserve swells the amount under the control of the latter, and consequently of the balance he deems it prudent to maintain with the Bank of England. Thus our system is so knitted together that a demand for cash, in whatever part of the country arising, has a prompt effect, to a less or greater degree, on the bankers' balances at the Bank of England.

From this can be seen the great importance of bankers' balances, and the great responsibility thrown on the Bank of England of keeping itself strong enough to meet demands from all quarters. The system is certainly a peculiar one, that results in all

banks keeping a large part of their surplus funds with another bank, and that not a State bank, though the banker of the State. It is an interesting fact that on many occasions since the passing of the Act in 1844 the "reserve," or actual cash held by the Bank of England, has been less than the bankers' balances alone.

This custom of the reserves being held by a central bank has been, and is, the subject of much criticism, principally on the ground that a "one reserve system" is not a sufficient guard against disaster in time of crisis, and that it would be a much safer method were each bank to keep its own special reserve in cash against sudden need. The discussion of the subject during the last few years, combined with other circumstances, has led to some increase in the cash held by bankers in general, and several banks are understood to have commenced keeping a special reserve in cash, on a small scale. The whole subject is a very intricate one, and one that cannot be more than glanced at in the course of this small book.

Taken as a whole, and in ordinary times, "Other Deposits" indicate the state of the Money Market. They rise and fall fairly regularly at certain known seasons of the year; but if they rise above the

average for the time of year, it may be taken as an indication that money is abundant, and that bankers and others have funds in hand for which they cannot find profitable employment, and therefore the interest rate charged for the use of money is likely to fall. On the other hand, if "Other Deposits" are below the average, money is evidently in request, and rates are likely to rise. *This is in ordinary times.* In times of trouble, however, "Other Deposits" will rise considerably, and at the same time, interest rates will also advance. The reason of this is that on any note of alarm being sounded in the financial world, bankers will at once begin to strengthen their position—to "keep their powder dry"—and consequently will begin to increase their balances at the Bank of England. Owing to the curtailment in their loanable funds resulting therefrom, money will increase in value, and a higher rate will have to be paid for the use of it by borrowers.

Together with the bankers, other large customers of the Bank of England will increase their balances against emergencies, and possibly, if the trouble become acute, money will be transferred to the Bank from other banks for greater safety. Thus in such times we see the "Other Deposits" of the Bank increasing, while the deposits of other banks are

decreasing. It is related that during one crisis a customer of a certain bank became alarmed, and drew out his balance. Not knowing what to do with his money when he had got it, he wrote to the financial editor of one of the great daily papers, asking him where it would be safe to put it, and quickly got back the reply, "Put it in the ——," naming the same bank from which the customer had withdrawn it!

The remaining item on the liability side of the Banking Department, namely, "Seven-day and other Bills," largely explains itself by its title. The item is not a growing one, as can be seen by referring to the first return issued after the passing of the Bank Act in 1844, when the amount under this heading was over one million pounds.

The seven-day bills referred to are what are known as Bank Post Bills, and are practically drafts on the Bank of England. The custom of issuing these bills appears to have originated about the year 1738, when, in response to representations, the Bank announced that it would give "bills payable at seven days' sight, that, in case of the mails being robbed, the proprietors might have time to give notice thereof." The changes which have occurred since this date, and even since 1844, amply account for the falling off in this item. It may be noted that the

Bank does not take advantage of the customary three days' grace in respect of these bills.

Government Securities.—As an ordinary bank in issuing its balance sheet roughly summarises the classes of securities in which its funds are invested, so does the Bank of England in its Weekly Return. The item "Government Securities" comprises, as its name indicates, the amount of all securities held which are guaranteed by the British Government, and it also includes any temporary advances made to the Treasury on "Ways and Means" or "Deficiency Bills." Advances which are made on the security of "Deficiency Bills" are generally required at the end of each quarter, excepting the March quarter, when, as we have seen, the Public Deposits are large, and the advances are required to meet the interest due on the public funds at the beginning of the ensuing month. The advances are repaid in the course of a few weeks from the incoming revenue. While in force they have the effect of increasing the figure at which Government Securities stand, and also, on the other side of the account, of increasing the total of Public Deposits.

Other Securities.—Under this heading are included all the investments of the Bank other than Government Securities—investments in general securities,

loans, bills under discount, and advances to bill-brokers.

No particulars are given as to the amount invested in the various items above mentioned; the investments in general securities, and the loans to ordinary customers of the Bank, may be presumed to be fairly steady in amount, as is the case with other banks; but the amount of investments in bills under discount and of advances to bill-brokers are subject to wide fluctuations from time to time. These fluctuations are due to the complicated system of our Money Market. As will be explained later, ordinary banks employ a certain portion of their funds in advances to bill-brokers. These loans are either repayable at "call," or are fixed for a certain number of days, and the amount lent varies with each particular bank from day to day, and from week to week. In the aggregate, however, the amount advanced in this way by all the banks combined is not subject to much fluctuation, for this reason—what one bank may lose in available lending balance another will gain, and so the total is not materially altered. At certain seasons of the month and of the year, however, or during periods of threatened disturbance in the Money Market, this is not the case. Circumstances may compel several

or even all the banks simultaneously to call on the bill-brokers to repay their advances or part of their advances. Thus the aggregate of the money lent in this manner is materially reduced.

The bill-brokers, finding that they cannot obtain the funds from the ordinary sources wherewith to repay the amounts "called" from them, must have recourse to the Bank of England—both for discounting bills and for short loans. These facilities are there granted to them on certain conditions. The accommodation thus granted to the bill-brokers amounts to very large figures when the resources of the Money Market become locked up, owing to some special cause, such, for instance, as the issue of a big loan like the Transvaal loan of May, 1903. For this loan the "application money" alone, in the hands of the Bank of England, amounted to over £35,000,000, the bulk of which had been temporarily taken from the balances of other banks, thus reducing their lending powers and compelling them to call their advances from the bill-brokers.

Notes, and Gold and Silver Coin.—These two items together form what is known as the "Reserve" of the Bank, and the Reserve is the most important item appearing in the Weekly Return, and the item on which the attention of the Money Market is constantly fixed.

On looking at the balance sheet of one of our joint-stock banks, we find that the first item appearing among the assets of such an institution is "Cash in hand and Balance at the Bank of England"; but it is impossible to tell from this how much is actual cash, and how much balance at the Bank. The average proportion of "Cash and Bank of England balance" to "liabilities to the public" held by our leading joint-stock banks is about 15 per cent., while the proportion of "Cash" (Notes, and Gold and Silver Coin) to "liabilities" with the Bank of England has averaged 50 per cent. during the last ten years, and the fall of its reserve to anything like 15 per cent. would doubtless be coincident with a world-shaking panic. The reason of this great divergence in the proportion of cash in hand held by the Bank of England in comparison with other banks needs explanation, as do also the means taken to maintain the Reserve at a figure of presumed safety.

The "Reserve" is the reserve of the Banking Department only, and has no connection with the Issue Department as regards the convertibility of its notes. The great importance that is attached to the Reserve being maintained at a large figure is due to the fact that not only can this Reserve

be drawn upon for home requirements, but that it is open to attack, and serious attack, from abroad.

As regards home requirements, the needs of the public in usual times follow a regular course, and one that is known and can be provided for beforehand; but this is not the case as regards foreign demands, and it is in connection with these demands that most of the changes in the Bank Rate owe their origin. If the directors of the Bank of England had to deal with home demands only, the question of fixing the Bank Rate would be an easy one—that is, of fixing the rate at which they are nominally prepared to discount for the public and for bill-brokers, and the rate which, by custom, governs the interest allowed on deposits and in many cases the rate charged for loans by other banks. But London is the most open market for gold in the whole world, and any country which requires gold for any purpose can draw it from London with more ease than from any other quarter. Hence our stock of gold is peculiarly open to attack, and in fixing the Bank Rate from time to time, the directors have to consider the question of whether gold is coming to us or leaving us. If gold is coming here in large quantities, the Reserve will improve, money will be plentiful with ordinary banks, who will consequently

be prepared to lend at cheaper rates—considerably below the advertised rate of the Bank of England—and that institution will gradually lower its rate so as to keep in line with the prevailing conditions. On the other hand, if gold is leaving us in considerable quantities, the Reserve will of course fall, and this will be followed by a gradual tightening of rates in the Money Market, and the Bank Rate will be raised, not only in order to check the export of the metal, but to attract imports. Why a high Bank Rate is likely to attract foreign gold to our shores, and a low rate to have the contrary effect, will be explained in a later chapter dealing with the Foreign Exchanges.

CHAPTER VIII

THE GROWTH OF JOINT-STOCK BANKS

WE have already seen in dealing with the Bank of England that the formation of a bank with more than six partners was *supposed* to have been expressly prohibited by the Bank's Charter. The direct result of this presumed prohibition was the establishment throughout the country of a large number of small private banks. Many of these were institutions of credit, ably managed and backed with a fair capital; but the majority of them were weak, and in times of trouble proved a source of danger and loss to the community. The various financial crises of the later part of the seventeenth and the early part of the eighteenth century gradually brought home to the people and the Government the unwisdom of the system whereby the growth of small banks was fostered, and the establishment of large and wealthy institutions was forbidden. At length—in 1826—the Bank of England was by Act

of Parliament compelled to part with a portion of its presumed monopoly, and joint-stock banks were allowed to be established outside a sixty-five-mile radius from London.

It is somewhat remarkable that after the formation of joint-stock banks was at last permitted, very small advantage was at first taken of the permission thus afforded; one joint-stock bank was founded at Lancaster, another at Bradford, and a third at Norwich. But it was not until a period of commercial prosperity set in that any considerable number of such banks were founded. In the year 1833, however, and for a few following years, a large number of provincial joint-stock banks sprang into existence.

The presumed monopoly of the Bank of England within the sixty-five-mile radius was next called in question in London, and it was asserted that the monopoly consisted only of a prohibition of the formation of banks of issue, and steps were taken to found a joint-stock bank in London. This was strongly opposed by the Bank, which tried to have its Charter so amended that its monopoly might be complete. This proposal of the Bank of England was, in its turn, strongly opposed by the Government, which not only refused to alter the Charter,

but, at the next renewal thereof, in 1833, actually inserted a clause expressly permitting joint-stock banks to be established within the sixty-five-mile limit, provided that such banks did not borrow or take up in England any sum or sums of money on their bills or notes payable on demand or at less than six months from the borrowing thereof.

No sooner had this clause become law than advantage was taken of it, and the formation of the first joint-stock bank in London was commenced. This bank was the London and Westminster, which was established in 1834, and it was quickly followed by the London Joint Stock Bank in 1836, and the Union Bank of London and the London and County Bank, both in 1839.

The London and Westminster Bank commenced business in the city of London and at Westminster in March, 1834; at that date the paid-up capital was £50,000 only; but that the bank quickly commanded confidence, and began to gather together a lucrative connection, can be gathered from the fact that by the close of that year its balance sheet showed that it held balances belonging to the public of over £180,000. The paid-up capital had by then been increased to about £180,000.

The earlier joint-stock banks which were established

in London had to contend with many disadvantages. They were not allowed by the Bank of England to open current accounts with that institution, and the private bankers would not allow them the facility of being represented in the Clearing House—an institution to which we shall refer later.

They were likewise troubled with legal difficulties, as the position of the shareholders of such banks was merely that of a common law partnership; and consequently, in any action, the exact names of all the shareholders had to be given, and all were parties to the action. This inconvenience was remedied by an Act passed in 1838, which allowed a banking company to sue or be sued in the name of any of its members; but the position of its shareholders still remained the same as to their unlimited liability, and it was not until the year 1858 that an Act was passed allowing joint-stock banks to take advantage of the system of limited liability; a system which was first allowed to ordinary joint-stock companies by an Act passed in 1855.

Another inconvenience with which these banks had to contend was occasioned by the enactment providing that no such partnership could accept bills having a less date than six months. Various expedients were tried to circumvent this difficulty, but none were

successful, and it was not until the year 1844 that joint-stock banks were released from this incubus.

In spite of so many embarrassing and hindering circumstances the joint-stock banks more than held their own, and gradually increased their wealth and importance. From small beginnings they gathered strength as the years rolled on, and little as the originators of the movement may have imagined to what colossal proportions the business would attain to-day, the joint-stock banks of England and Wales together hold deposits from the public exceeding the enormous sum of £600,000,000; a sum nearly equal to our National Debt.

The number of our banks, both private and joint-stock, has been decreasing for many years. This is owing partly to the failure of the weaker banks of both classes, but chiefly to the numerous amalgamations of recent years. At the close of the year 1849 there were ninety-nine joint-stock banks established in England and Wales, at the close of 1892 there were one hundred and two, and at the close of 1902 only sixty-eight, not including the Bank of England. These banks then held deposits amounting to no less a sum than £600,333,000. The decrease in joint-stock banks in the last ten years, from one hundred and two to sixty-eight, is remarkable; but this does not neces-

sarily imply any lessening of banking accommodation to the public; on the contrary, the reverse is the case, owing to the great increase in the number of branches which have been established.

According to the *Economist*, there were 2,336 banking offices belonging to joint-stock banks open to the public in England and Wales on the 31st of December, 1891, whereas on the 31st of December, 1901, the number had nearly doubled and stood at 4,146. The network of banks thus spread over the length and breadth of the land has resulted in tapping new sources of business. An enormous number of people now keep banking accounts who previously did not do so, but who used to pay cash for all their purchases and keep their money in the proverbial stocking. Though the average balances maintained by this new class of customer may be small, it is a case of "many a mickle makes a muckle," and the aggregate of new balances so obtained has largely helped to swell the total balances in the hands of the banks. In 1892, one hundred and two joint-stock banks of England and Wales held balances amounting to nearly £400,000,000, whereas now, as already mentioned, a sum exceeding £600,000,000 is in the hands of the banks. It must be remembered, however, that a considerable portion of this increase is due to the fact

that a large number of private banks have been absorbed by joint-stock banks during the ten years in question, and that the balances held by the private banks so absorbed were not included in the figures of ten years ago.

Some of the joint-stock banks of London established branches in certain mercantile districts of the town early in their career, but they were slow to see the advantage to be gained by opening branches in the suburbs, and by catering for the wants of private individuals, tradesmen, and the smaller classes of merchants and manufacturers. But the conspicuous success which attended the efforts of one or two institutions in this direction, drew the attention of other banks to the advantages to be gained by keeping level with the growth of Greater London, and providing what is required by its inhabitants. The result is that the suburbs of London are now as well, or better, provided with banking accommodation than any other part of the kingdom; and so great is the competition among various banks in this direction, that the limits of discretion appear to be overstepped in certain districts, as to the number of branches which can possibly obtain a profitable business from those localities.

As regards capital invested in banking companies,

we find an increase, but not anything like the same proportionate increase that the balances exhibit. The paid-up capital of the joint-stock banks of England and Wales at the end of 1892 (not including the Bank of England) was about forty-four million pounds, and by the end of 1902, or in ten years, it had only increased to about forty-seven and a half million pounds; and this in spite of the capital represented by absorbed private banks not appearing in the former total.

The "Reserve Funds" of the banks, however, show a fairly satisfactory increase of six millions, from twenty-eight millions to thirty-four millions in the ten years.

Adding together the two items of Capital and Reserve, so as to arrive at the total working capital, we find that this has increased from seventy-two millions in 1892, to eighty-one and a half millions in 1902, or an increase of little more than 13 per cent., while the balances increased about 50 per cent. in the same time. The uncalled and reserved (*i.e.* capital which can only be called up in the event of failure) capital of the banks increased from one hundred and fifty millions to one hundred and sixty-three millions, or an increase of slightly under 10 per cent.

Turning from the consideration of the amount of funds which the joint-stock banks have at the present time within their disposition and control, to the question of how they employ those funds, it is interesting to note the changes which have taken place during the last ten years. The main portion of a banker's assets is divided between—

1. Cash, and the balance maintained at the Bank of England or with a London agent, and money at call or short notice.
2. Investments.
3. Discount and Advances.

As regards these three items, we find the following changes have taken place during the last ten years. At the end of 1892 the joint-stock banks held nearly ninety-four millions in cash, etc.; they now have nearly one hundred and sixty-five millions. This represents an increase of about 75 per cent., and is a very satisfactory feature in present-day banking, indicating that the question of keeping a stronger cash reserve is receiving attention, the liabilities in the time having increased only 50 per cent. As regards investments, ninety-five millions was held in this form in 1892, against one hundred and thirty-one millions ten years later, an increase of 38 per

cent.; while Discount and Advances have increased from two hundred and eighty-three millions to three hundred and eighty-seven millions — which represents an increase of about 37 per cent. These proportionate increases of Cash, Investments, and Advances and Discounts have taken place while the balances have proportionately increased 50 per cent. In the next chapter we shall proceed to examine in more detail the composition of the balance sheets of banking companies, and the relative proportions which the items appearing therein bear to each other, or should bear to each other, to be in accordance with the system of business maintained by our leading banks.

For ready reference we append on the next page a short table relating to the figures which we have been considering in the present chapter. These figures amply show the advance made by joint-stock banks during the last ten years.

AGGREGATE FIGURES OF THE JOINT-STOCK BANKS OF ENGLAND AND WALES (EXCLUDING THE BANK OF ENGLAND)

,000,000 omitted (except in the last two columns)

Date.	Balances Held. (1)	Paid-up Capital. (2)	Reserve Funds. (3)	Uncalled and Reserved Capital. (4)	Cash Bank Balances and Call Money. (5)	Per-centage of (5) to (1). (6)
December, 1892	397	44	28	150	94	23·7 %
" 1902	600	48	34	163	165	27·5 %

Date.	Invest-ments. (7)	Per-centage of (7) to (1) (8)	Dis-counts and Ad-vances. (9)	Per-centage of (9) to (1). (10)	Per-centage of (5)+(7)+(9) to (1). (11)	Number of Joint-Stock Banks. (12)	Number of Bank-ing Offices. (13)
December, 1892	95	23·9%	283	71·3%	118·9%	102	2,326
" 1902	131	21·8%	387	64·5%	113·8%	68	4,146

CHAPTER IX

JOINT-STOCK BANK BALANCE SHEETS

THE object of a joint-stock bank is to pay a dividend on its share capital at a rate as high as can be earned consistently with the performance of the main obligations of such a bank, that is, the safeguarding of moneys deposited with it by customers, and of capital subscribed by shareholders.

With regard to moneys deposited, it must be borne in mind that the relation of banker and customer is that of debtor and creditor; and as the bulk of a banker's liabilities is repayable in cash on demand, without notice of any kind, it behoves him so to conduct his business that he may be in a position to meet any demand, and that without delay or hesitation—or ruin stares him in the face.

We have already seen that before banking—as we understand it—was practised in England, moneys were deposited with the goldsmiths for safe keeping only and that in course of time the goldsmiths realised

that they were never called upon, at any one time, to repay the whole amount deposited with them; that an undemanded portion always remained in their hands which they could safely use for their own profit. This principle, indeed, constitutes the foundation of modern banking. But the question of what demand *may* be made on any particular day, or during any given period, has to be considered and provided for by each banker for himself. Experience teaches that on an average over any lengthened period the payments are met in the aggregate, and more than met, by new deposits. This is evidenced by the steady growth of balances held by the banks.

The receipts for any one particular day, or during any short period, however, may, and frequently do, fall short of the payments. At the end of each week, for example, bankers lose a large amount of cash, which is drawn for wage-paying purposes, and it is not for several days that this cash gradually dribbles back through tradesmen paying in the money they have received from the wage earners. A similar depletion of cash takes place at the end of each month for the payment of salaries. Again, about the middle of each month suburban and provincial banks have their balances depleted owing to retail customers paying the monthly accounts of their

wholesale houses. (This latter demand is not for cash, however, but is satisfied from the Bank of England balances, which, of course, has the same ultimate effect as if actual cash were drawn.) At the end of each quarter there is also a disturbance of balances for rents then falling due; and finally, in the summer and autumn months much actual cash is taken temporarily from the banks for harvest and holiday requirements. Thus the banks lose a portion of their cash or bank balance on certain days and at certain seasons of the year. These demands are all *known demands*, and the banker is prepared accordingly.

It is not sufficient, however, that a banker should be in a position to meet *known* demands; unforeseen demands may be sprung upon him at any moment, and he must be prepared to meet them immediately they arise. Mr. Bagehot, in his *Lombard Street*, writes as follows of these unexpected demands:—

"Any sudden event which creates a great demand for actual cash may cause, and will tend to cause, a panic in a country where cash is much economised, and where debts payable on demand are large. In such a country an immense credit rests on a small cash reserve, and an unexpected and large

diminution of that reserve may easily break up and shatter very much, if not the whole, of that credit. Such accidental events are of the most various nature: a bad harvest, an apprehension of foreign invasion, the sudden failure of a great firm which everybody trusted, and many other similar events have all caused a sudden demand for cash."

A banker therefore fortifies himself against any sudden or unexpected call by keeping much more cash in his till than he is ever likely to require in normal times; by maintaining a large balance with the Bank of England—which to all intents and purposes is equivalent to "cash" in the till; and by lending out large amounts to bill-brokers, which advances are fully secured, and are repayable either on demand or at short notice. He is able to arrange the amount advanced in this way from day to day —by lending further sums or calling in loans— according to the circumstances of the moment, so that he can maintain that amount in "cash" or "bank balance" which he considers necessary for his safety.

So we see that "cash" and "balance" at the Bank of England together constitute a banker's first line of defence—they are, so to speak, his "firing line"— and the money which he lends to the bill-brokers constitutes the "supports" to the "firing line."

The next defence which a banker maintains against possible pressure is represented by the amount invested in securities. Investments yield on an average a higher return than sums lent at short notice or call; but it must be remembered that securities are not so easily realised, if the necessity should arise.

Of these investments a large portion is represented by Consols, as, in case of need, these can always be sold for cash at very short notice, or in case of great pressure doubtless the Bank of England would be willing to make advances on the security of this stock. Of securities guaranteed by the British Government, other than Consols, there will probably be a large holding, although these securities might not in time of panic be so readily realisable as Consols. Yet it is probable that the Bank of England would, in order to avert disaster, accept such stocks as security against advances. Other high-class securities which yield a somewhat higher return will also probably be held to a large amount. A banker, however, should not rely too much on these securities for purposes of realisation in time of monetary pressure, it being quite possible that at such times there would be no buyers of any class of securities, with the probable exception of Consols.

After making due allowance for "cash," "bank

balances," "call money," and "investments," a banker employs the balance of his funds in discounting bills, buying bills from the market, and making advances to customers.

As the dates when bills fall due for payment are fixed, if for any reason a banker deems it prudent to increase his "cash" and "bank balance," he can readily do so by letting his bills in hand mature, and not taking up new bills in their place. It is open to the banker to sell the bills he holds, that is, to rediscount them, if he choose to do so; but this course is not practised at the present day, except by a few country banks. Moreover, in the event of a panic, probably no one can be found to buy bills, so that they are not in practice realisable before the maturity dates. As an illustration of this, it may be mentioned that on one occasion during the crisis of 1847, it was found to be impossible in the city of London to discount even an Exchequer Bill of the English Government.

Of the various investments of a banker, "advances to customers" are the most difficult to realise in time of pressure, as the wherewithal for the customers to repay their advances is then wanting, and in their efforts to obtain necessary funds the danger would only be aggravated. In such times, indeed,

the commercial world requires extra assistance to avert an actual crash.

"Premises" is an item appearing among the assets in balance sheets of joint-stock banks. It is probable that in many cases the value of the premises largely exceeds the figure at which they are put in the accounts, and hence they constitute a hidden reserve; but the investment, by its nature, is one that cannot readily be made available to meet sudden demands.

We see, therefore, that a banker's assets usually consist of the following six classes of investments:—

I. Cash in the till and balance with Bank of England (or London agent).

II. Money lent at call or short notice.

III. Investments—
- (*a*) Consols;
- (*b*) securities guaranteed by the British Government;
- (*c*) other securities.

IV. Bills under discount.

V. Advances to customers.

VI. Premises and sundries.

The first three of these classes constitute what is known as a banker's "liquid assets."

TABLE SHOWING, IN THE CASE OF NINE REPRESENTATIVE JOINT-STOCK BANKS, THE PERCENTAGES OF THE VARIOUS CLASSES OF ASSETS RESPECTIVELY TO THE AMOUNT OF LIABILITIES TO THE PUBLIC.

Bank.	Cash and Bank Balance.	Call and Short Money.	Invest-ments.	Total of "Liquid Assets."	Bills, Advances, Premises, and Sundries.	Total Assets.
A	14·9	13·4	20·4	48·7	60	109
B	16·4	8·7	16·8	41·9	66	108
C	18·3	6·5	22·0	46·8	59	106
D	13·8	5·4	30·3	49·5	68	117
E	14·6	5·6	26·6	46·8	69	113
F	17·0	23·0	16·0	56·0	60	116
G	12·4	25·0	17·1	54·5	60	114
H	14·4	8·7	31·5	54·6	50	105
I	16·5	16·1	11·0	43·6	66	110

The averages of these percentages* respectively are as follows:—15·3, 12·6, 21·3, 49·2, 61·6, and 111.

On examining this table it will be noted that the proportions of funds invested in "liquid assets" do not vary materially with the different banks. When we examine, however, the separate classes of investments making up the total of "liquid assets," we see that the case is different, and a wide divergence is shown. This is especially so in "call and short money," where the proportions vary from 5·4 per

* These averages are not the percentages which would be shown by a *combined* account of the nine banks.

cent. to 25 per cent., and in "investments," where they vary from 11 per cent. to 31·5 per cent.

The figures given are those of one particular day, and that a day on which, according to popular belief, some of the banks indulge in what has been called by the Press "window dressing"—that is, adjusting to a greater or less extent the amounts held in the respective classes of securities, with a view to the presentation of more impressive figures in the balance sheet to be published as at that day. Had we the actual daily records of the various banks at our disposal, it is not improbable that a greater variation would be shown in the items of "cash" and "call money"; but these figures are not available. It is true that most of the banks now publish monthly statements as to their position, and it is a noticeable fact that while some banks issue these monthly statements as on the close of business of the last day of each month, others vary the day on which the statements are made up; and it is open to conjecture that this variation of date is with the object of making a better showing.

It must not, however, be inferred that such a course as this ("window dressing") is the usual one adopted by our banks; but it is a method of business which is possible, and which rumour has it is pursued

in certain cases. This explains such remarks in the money articles as, "Money was in request to-day, owing to a large amount being called off the market by the banks for window-dressing purposes."

As regards "call and short" money, it is possible that in time of actual panic a considerable portion of it would not be repaid when "called," especially as regards the "short" money. It is generally believed, though not stated in any balance sheet, that a large part of this "short" money is not lent to the bill-brokers, but to the Stock Exchange—that is, to stock-brokers. Loans to the Stock Exchange are fixed from one account to the next (about a fortnight ahead), and are then supposed to be paid off if required. In time of difficulty, however, would—or rather could—this money be repaid by the various brokers to whom it is lent? Supposing a broker had a loan of £100,000 secured on American railroad shares, and a crisis suddenly developed, from where could the broker obtain the money to repay the advance if it were called in? He would not be able to sell the shares without serious loss, if at all; and he would have great difficulty at such a time to induce another banker to make him a fresh loan. In all probability the loan would *not* be repaid, however much the lending banker was

desirous, or in need of regaining possession of his money.

Therefore such loans to the Stock Exchange (excepting, perhaps, amounts secured on Consols or such like) cannot fairly be entered under the heading of "call and short" money in a balance sheet. It is desirable, for these reasons, that balance sheets should give more explicit information than is usually the case; and more particularly they should specify separately the amounts lent to the bill-brokers at "call" and "notice," and the amount lent to the Stock Exchange from account to account.

Turning to the question of "investments," it may be noted in our table that those banks which show only a small proportion of "call" money, in most cases show a large proportion of "investments"; while, on the other hand, those which show a large amount at "call" hold only a small amount in "investments."

The table exhibits a wide divergence in the proportions of "investments" held. These proportions vary from 11 per cent. to 31·5 per cent. The actual proportion of investments held, however, is not of so much concern as the nature of the securities which compose the investments; that is, whether or not they are readily realisable in case of need. The

classes of investments are fairly shown in most bank balance sheets, and from a study of these some useful information can be gained. As an illustration of this, bank E in the table on page 94 shows in its balance sheet approximately the same holding in Consols as bank I, but the latter bank has deposits from its customers of twice the amount shown by the former. Now if bank E were to reduce its Consols by one-half (giving the same proportion as I), and put the proceeds in "cash" and "call money," its position would appear thus (using the actual figures of Consols shown by the balance sheets of the two banks)—

Cash and call money .	23 per cent.
Investments . .	24 per cent.

while bank I (as shown by the table) stands—

Cash and call money .	32 per cent.
Investments .	11 per cent.

This somewhat reduces the wide disparity at present shown in the respective figures, and it is quite possible that this difference could be still further reduced if we knew the actual amount held by each of these banks in securities, other than Consols, guaranteed by the British Government, and made the same assumptions with regard to these as in the case of Consols. As a matter of fact, considerably

more than half of the 26·6 per cent. of investments held by bank E appears in the balance sheet of the bank as being composed of such securities, and these might prove a more valuable asset in time of trouble than so much money nominally at "call" or "short notice."

From this example we can see that in examining the balance sheet of any bank, particular attention must be paid to the composition of the investments, whether they are of such a character that one may fairly rely on being able in time of stress to realise them immediately, or, in the alternative, borrow from the Bank of England on their security. We may repeat, as the matter is of importance, that the actual amount of securities held, or the proportion which they bear to the total balances, is not of such importance in the case of a bank, as the nature of the securities which form the investments. One London bank's investments simply consist of a large holding of Consols; and though times might conceivably come when it would be impossible to realise even such a holding at short notice, yet such an investment forms a backbone and reserve which cannot be overestimated.

Having considered the securities which constitute the "liquid assets" of bankers, we will now briefly

turn our attention to the manner in which the remainder of bankers' funds are usually utilised. As we have already seen, this remainder is used mainly in discount operations and advances to customers, while a certain amount is generally sunk in premises, etc. These three items have been classified together in our table, as the necessary information is not given in some of the published balance sheets to enable us to specify them separately. As regards "premises," it may be repeated that though they form a valuable asset, yet they are not an available one, and would, generally speaking, only be realised in the event of a winding-up.

The bills held under discount comprise bills which are discounted for the customers in the ordinary course of business, and also bills bought from bill-brokers; and they constitute a fairly available asset.

The "Advances" to customers is a security of a very fixed nature. In times of trouble it is the asset most difficult of realisation, and it is the rock on which the majority of banks which have come to grief have struck.

No information respecting this asset is vouchsafed in any balance sheet beyond the bare total. It is a known fact that banks are lenders on practically any kind of security which has a fairly steady value,

and in which there is a "market"; stocks, shares, produce, houses, lands—all are offered as security, and all are accepted under various conditions. But it is of the utmost importance that bankers should closely watch and scrutinise the aggregate of advances which they may make upon any one kind of security, so as to keep the amount within due limits. If too large a sum is advanced on one kind of security, and that security should become much depressed in value, the banker may be caught between two fires: on the one hand, the customers who have deposited this security will, from its fall in value, have become financially weakened, and perhaps not be in a position to repay the advances; and on the other hand, if the banker wish to repay himself by realising the securities, he may find that the margin of value has run off, and what can be obtained by selling the securities in the market will not cover the advances, or possibly, for the time being, they will prove to be unsaleable. Thus he will be left in the dangerous position of having a considerable proportion of his assets indefinitely locked up, and a certain number of his customers in a weak and reduced condition financially.

Neglect of the precaution of spreading advances over different suitable classes of investment has

brought many banks to ruin in the past, and under similar conditions would do so in the future. This danger is not now so pressing as in former times. Owing to the present custom of establishing branches, and to amalgamations, the operations of banks are now frequently spread over wide areas, and therefore automatically their advances tend to spread over many more industries and securities than was formerly the case. When banks were more local, their prosperity rose or fell with the industry and conditions of their particular district.

We see then there is danger in locking up too large amounts in advances on any one class of security. But there is an equal danger in advancing too large sums to a few customers. A firm may be of very good standing and report, and keep a first-class and highly remunerative account with its banker. From time to time it has advances from its banker, which he is very glad to make, and which are regularly repaid. But a time may come when an advance may not be repaid when due; instead, a further advance is asked for. This is made without question, and probably further advances, always increasing and never reducing. After a time the banker may become a little fidgety, and cautiously suggest a reduction, but will probably be told that

ample funds will come to hand shortly. When this time comes the funds may not have been received, and the customer may insist that he *must* have further help, or he will not be able to meet his obligations. The banker should require ample cover before advancing further sums; but if he is weak and yields to pressure, matters will go from bad to worse, until the customer may practically rule and command the bank, the two concerns will be involved together, and when the customer "goes" the banker will go too, or at the best suffer a big and weakening loss—not only loss of money, but loss of credit, which will affect him seriously in the future, and may ultimately cause his fall.

This danger is not a hypothetical one. It is unfortunately founded on fact. It was this cause which led to the disastrous and all-reaching failure of the City of Glasgow Bank. When the position of that bank was examined it was found to have lent as much as six million pounds among four customers. Gilbart says: "Almost every bank that has failed can point to some one, two, or three large accounts to which it mainly attributes its failure."

On looking at the last column of our table we see that all the banks hold assets in excess of liabilities to the public; the excess is in respect of the capital

and reserve fund. As an additional security for the depositors, each bank has only a part of its subscribed capital paid up. The remainder, the uncalled capital, constitutes an extra reserve for the benefit of the depositors.

The profits made by joint-stock banks are high, the majority of dividends varying between 10 and 20 per cent.; and notwithstanding such satisfactory dividends, large reserve funds have been accumulated from undivided profits. These reserve funds in some cases equal, and even exceed, the total of the paid-up capital. It may be added that many of the banks are popularly credited with holding other reserves which do not appear in their balance sheets.

CHAPTER X

THE BILL-BROKERS

THE business of the bill-broker is one that has grown up during the past century—chiefly during the latter part of it. A bill-broker acts the part of an intermediary between banker and merchant. At first glance the need of such an intermediary is not very apparent, considering the large number of banks now in existence which keenly compete for business. On looking further into the matter, however, the importance and utility of the bill-brokers, both to banker and merchant — that is, to those who wish to buy bills and those who have them to sell—become apparent.

To undertake the business of discounting bills successfully great knowledge and discrimination are necessary; knowledge that can only be obtained by experience, and discrimination by keeping in touch with the changes occurring in the standing and position of the mercantile and financial com-

munity. As with the rest of the world, merchants and financiers do not stand still; they progress or they fall back. Many bills which in 1893 would have been treated as first-class paper are now, in 1903, looked at askance; while the acceptances of many firms who were unknown ten years ago are now readily taken. It is the business of the bill-broker to keep himself thoroughly informed of the "standing" and "position" of the mercantile community, so that he can readily discriminate good bills from doubtful ones.

A bill-broker does not confine his operations to what is called "bank paper"—that is, to bills accepted or endorsed by one of our well-known banks or leading finance houses—but he is prepared to deal in bills accepted or endorsed by members of the ordinary mercantile community, provided he is satisfied as to the position of the parties whose names appear on the bills. These latter bills are called "trade bills." The rate for discounting such bills is always somewhat higher than the rate for bank paper because of the slightly greater risk.

The bankers of the present day discount a large number of bills for their customers in the ordinary course of business. Bills obtained from this source, however, do not meet a banker's requirements in

several particulars. For one thing, the amount of bills offered directly to bankers for discount is not sufficient, as a general rule, to satisfy their demands; and, moreover, a banker has no power of regulating the supply of bills offered to him in this way. One day he may be asked to discount bills to a very large amount, when he is not anxious to increase the amount of his holding of bills; on another day he may wish to increase his holding, but none may come forward. And lastly, with bills offered for discount by ordinary customers a banker has no power of so picking his bills that he can ensure having a large amount of bills maturing at any given period, when he anticipates that he will require to increase his cash. But all these conditions can be met by dealing with the bill-brokers. A banker can obtain bills to any desired amount from the bill-brokers, he can regulate the supply of the same according to his wishes, and he can stipulate that the bills sent in by the bill-brokers are to mature within any given time—thirty days, sixty days, ninety days, and so on; and he is thus in a position to provide automatically for an expected demand for cash at certain times, by the maturing of bills.

Bankers therefore find it easier, and, owing to

the broker's specialised knowledge of the position of parties, on the whole safer, to buy bills from the bill-brokers than to try to obtain directly all that they require. Bills so purchased possess a further advantage, for not only are they secured by the names on them, but, in addition, they usually carry the guarantee of the bill-brokers as well; and this, when dealing with large and wealthy firms, is a distinct advantage. It must also be remembered that there are a large number of banks—principally country banks—who are so situated that in the ordinary course of business they never have what is called "A1 paper" offered to them for discount, and yet they require to invest a certain amount of their funds in such bills. These institutions of necessity make use of the bill-brokers to satisfy their needs.

In consideration of the bill-broker's guarantee, and of having had the advantage of his knowledge in selecting and collecting bills, a banker is content to buy bills from a broker at a slightly lower rate than the ruling market rate, usually $\frac{1}{8}$th or $\frac{1}{16}$th per cent. per annum lower. For instance, if bank or first-class paper is quoted in the market at $2\frac{3}{8}$ths per cent. per annum for bills due in three months' time, bankers would buy such bills from the broker at $2\frac{1}{4}$ per cent. The broker thus makes a turn of

about $\frac{1}{32}$nd per cent. on the deal, but in active times this "turn" is often divided with the merchant from whom he buys. This profit may seem small, but when the enormous turnover of a bill-broker is taken into consideration, it is apparent that the total profits derivable from this business are very considerable. This is confirmed by the satisfactory dividends paid by the two or three public companies conducting discount business.

Looking at the other side of the question, persons who have good bills to discount find they have a readier market in the bill-brokers than in the banks, and practically all the first-class bills throughout the country find their way to the London market for discount.

In order to keep their connection, bill-brokers must be prepared to do business in good bills at any time, to practically any amount; and to be in a position to do this, they rely either on borrowing the necessary funds from the banks, or on selling some of their stock of bills in hand to the banks. The interest on the call and short-notice money borrowed from banks is on an average materially lower than the rates at which bills are discounted, and consequently a profit is made by the bill-broker (who holds the bills he buys), of the difference between the

two rates; and when bills are sold to the banks a turn is made on the transaction, as we have already seen. Competition among the various brokers, however, is always tending to keep down rates, and consequently the profits of the business.

Bill-brokers also buy very large amounts of trade bills from colonial, and in some cases foreign banks, which are endorsed by the banks in question. These bills, when not held by the brokers, are sold to various banks throughout the country, and of course form a first-class security. It may be mentioned that it is not the custom now for any London bank to rediscount bills which they may have discounted for their customers, and only in very rare instances do country banks adopt this course, though the names of two or three of such sometimes appear as endorsers.

Unlike a banker, a bill-broker has to pay interest on all his working funds, and this makes him anxious always to utilise those funds to their fullest extent. Unlike a banker also, he has no large reserve of idle funds to keep for meeting sudden demands. Should such demands arise, he relies on being able to borrow from banks or elsewhere, sufficient funds to meet those demands, or, as a last resort, to obtain assistance from the Bank of England.

As regards the funds with which the bill-brokers conduct their business, we have already seen that they are largely borrowed from various banks. The business is very simple, and is marked by an absence of any kind of red tape. Every morning the representatives of the brokers call on the banks with which they do business, and ascertain whether the latter wish to lend any more money, or if any of the money already borrowed is required to be repaid; at the same time usually arranging the rate to be paid for money. They also ascertain if the banks wish to buy any bills, and arrange the rate for such business.

In the case of money being lent to a broker, he simply sends in security to cover the advance, and draws a cheque on the banker for the agreed amount. In the case of money being "called in" by a banker, the broker sends in his cheque on some other banker for the sum called, and takes away a corresponding amount of security.

The securities deposited by bill-brokers for loans of this class consist either of first-class bills or what are known as "floaters." "Floaters" are bearer securities of the highest class, such as Consol certificates, the debentures of certain Indian railways, the bonds of the Corporation of London and the London County Council. They obtain the name

of "floaters" from the fact that they float from bank to bank, as one bank calls and another lends.

In the case of a banker buying bills from a broker, the broker sends in a parcel of bills which roughly amount to the agreed figure, and draws a cheque for the amount less the discount. It is not usual for brokers to endorse the bills they so sell, but they give the banker a continuing guarantee in respect of all the bills which he may buy from them from time to time.

It frequently happens at certain seasons of the year when there is a pressure for money, or on special occasions—such as on the issue of a big public loan, when a large amount of bankers' floating balances is temporarily withdrawn—that heavy demands are made on brokers to repay money they have at "call" from the bankers. The brokers are then placed in the position of having large sums to repay, and as none of the banks are lenders, they are forced to apply to the Bank of England for assistance. The brokers are then said to be "in the Bank," and they usually try to get out as soon as they can, in order to escape the higher interest there demanded from them. Formerly the Bank of England declined to discount any bills for brokers and would only make them temporary advances

This rule, however, is now relaxed, and the Bank will either discount approved bills at the "official" rate, or make temporary advances. The bills discounted with the Bank of England are not supposed to have more than sixty days to run before maturity, and must bear the names of at least two British firms, one of which must be the acceptor.

The advances made by the Bank of England are not at "call," as with other banks, but for a fixed number of days, never less than three, and sometimes for as many as ten. The rate charged varies from Bank Rate to ½ per cent., or even 1 per cent., above that rate.

It follows from this that when brokers have to obtain assistance from the Bank, the rate for money in the open market at once begins to stiffen, as demand exceeds supply; and if any considerable amount has to be borrowed from the Bank, the outside rate will rise until it is on a level with the Official Rate; or even slightly higher, if the Bank is charging above the Official Rate for its advances.

Generally speaking, the aggregate amount of money from all sources available for the use of the market keeps approximately at a level figure, but a portion of it is not always in the same hands; and it is this shifting balance of market money

which really controls the rates charged for the use of the whole of the money. If this shifting balance finds its way into the Bank of England, all rates harden, owing to the competition among brokers to obtain money without applying to the Bank. On the other hand, if the shifting balance passes into the coffers of the bankers, the competition among them to lend their funds will tend to reduce the rate of interest which can be obtained for the use of the money.

CHAPTER XI

THE CLEARING HOUSE

A WORK dealing with the subject of the Money Market would not be complete without reference to the Clearing House—the institution by which our enormous financial operations are adjusted. Without such arrangements as are carried out so practically and automatically by the Clearing House, it would be impossible to carry on our present trade, and our banking system could not have developed into such a high state of efficiency as we at present find.

Although our Clearing House has now been established for more than a century and a quarter, London cannot lay claim to be the originator of the clearing system. Edinburgh established such a system some years before its adoption in London, and a somewhat similar arrangement appears to have been in vogue in certain continental towns, it is said, since the sixteenth century.

Up to the year 1775 all the cheques which a London banker held on other London bankers were presented daily to the bankers on whom they were drawn, and paid in cash or notes. Such a system was very inconvenient to both the collecting and the paying bankers, as not only did it entail the trouble of sending out clerks to present the various cheques, but every banker was bound to keep an unnecessarily large stock of cash and notes in his till, in order to be prepared to meet in cash any demand which might be made upon him. There was also considerable risk in the clerks' carrying about such large amounts of notes and gold.

In the year 1775 certain of the private bankers of London arranged a scheme between themselves whereby to minimise this inconvenience and risk. They hired a room in which the representatives of each bank met daily, and exchanged the cheques and bills which they held on each other. The *balances only* which each bank had either to receive or pay were settled in cash. By this means a great saving was effected in the use of actual cash, and the risk of transfer of large sums from bank to bank was to a large extent reduced.

At a later date the use of actual cash was still further economised. Each of the banks represented

in the Clearing House was compelled by regulations to keep an account at the Bank of England. After this regulation came into force, instead of cash being paid or received at the end of the day, as was formerly the case, each banker's account at the Bank of England was either credited or debited with the balance due to or by him on the aggregate of his daily transactions.

When the Clearing House was first established it met with much opposition, although its advantages were so apparent. Several of the largest bankers refused to countenance it. In course of time, however, the great advantages it possessed wore down all opposition, other bankers joined the "clearing," a regular set of rules was drawn up for the conduct of its business, and a committee of bankers was appointed to supervise its working.

On the establishment of joint-stock banks in 1833 they were prohibited from enjoying the facilities of the clearing system, owing to the jealousy of the private banks. It was not until 1854 that this jealousy was overcome, and the joint-stock banks permitted to join the Clearing House; but the Bank of England did not take advantage of the system until ten years later.

In the year 1858 the Country Clearing system was

established. Under this arrangement all cheques on country banks held by other banks are passed through the Clearing House into the hands of the London agents of the banks on which they are drawn. The London agent sends by post each night to the various country banks which he represents, a parcel of cheques consisting of the whole of the cheques on each respective country bank which have been passed to him through the clearing. Each of the country banks has thus but one remittance to deal with each morning, instead of numerous remittances from banks situated all over the country. On the other hand, the trouble to which each bank was formerly put of forwarding all country cheques received direct to the various banks on which they might be drawn was done away with.

The West End and suburban banks of London cannot, by reason of distance, be directly represented in the Clearing House. A system, however, is in operation by which practically the total of their daily transactions becomes merged in the total figure of each day's clearing. Cheques presented to these banks by other banks are paid by what is known as a "payment." A "payment" is in effect a draft on their head office or clearing agent, and these drafts are passed through the Clearing House.

By these various developments it has come about that the vast majority of bills and cheques passing through the hands of bankers, throughout the country, become focussed in the London Clearing House, and the returns of that institution, showing the total of the daily transactions with which it has dealt, consequently afford a good barometer of the state of trade throughout the country, the figures rising or falling as prosperity or depression affects our commercial condition. The returns are now published weekly, and the figures there shown are stupendous in their amount—the average daily clearing on ordinary days for the year 1902 amounting to £15,559,600, and on Stock Exchange settling days to £38,961,800, while the grand total for the year amounted to the record figure of £10,028,742,000.

Without going into detail as to the exact mode of procedure carried out in the working of the clearing system, we will roughly delineate the manner in which the transactions are brought to a head at the close of each day's work.

The clerks of each bank represented in the Clearing House make out a summary at the end of each day, showing the amount of the "articles" (cheques, bills, and drafts) which they have handed to the representatives of other banks, and the amount of the

articles handed to them by other banks, and the difference of these two figures shows the net amount which has to be received or paid as the result of the aggregate of all their transactions.

All the clearing banks must keep an account at the Bank of England, and a nominal account is kept at the Bank, called the "Clearing Bankers' Account." At the close of each day the amount owing by each bank, which on balance has to *pay*, is debited to that bank's account at the Bank of England and credited to the "Clearing Bankers' Account"; while as regards those banks which have to *receive* on balance, the "Clearing Bankers' Account" is debited, and the account of those banks credited. Thus while the Clearing Bankers' Account at the Bank is automatically balanced each day—as, in the aggregate, the credits of one set of banks must be balanced by the debits of the other set—the whole of the enormous total of transactions thus brought to one head is settled by a few dozen entries in the books of the Bank of England.

Quite recently, and not before it was absolutely necessary, the building of the Clearing House was largely extended, and the internal arrangements reorganised, giving greater facility for the work carried out there; and an innovation has been made in

supplying Burroughs' Automatic Adding Machines for the use of the clerks of the house. About one hundred and forty of these machines are now in use, and though when they are all at work the Clearing House is certainly not the quietest spot in the City, yet the convenience and great economy of time and labour resulting from their use cannot be fully appreciated by any except those in daily touch with the work.*

* Since the first edition of this book was published a new clearing has been established, called the "Metropolitan Clearing." By means of this new system, cheques on various branch and private banks situated within a certain radius of Lombard Street are collected through the medium of the Clearing House and the head offices of the various banks, and the total of such collections is brought into the daily general settlement of the "House," thus swelling the already enormous figures. This system has certainly increased the efficiency and unification of the Clearing House, and it has almost entirely eliminated the well-known "walk clerk."

CHAPTER XII

FOREIGN EXCHANGES

IN the course of this book reference has been made on several occasions to the influence on the Money Market of the foreign exchanges. It will be impossible in the course of a short treatise such as this to enter fully into details and technicalities. Anyone wishing to obtain a fuller explanation of the subject cannot do better than study Mr. George Clare's book entitled *The A B C of the Foreign Exchanges.*

Bills of exchange have been used in settling commercial transactions since very early times. The Romans appear to have employed them to some extent, but it is to the early Italian, and even more to the early Jewish merchants, that we owe the development of the system. By the fourteenth century the use of bills was firmly established, and their form, and the laws and customs relating to them, were much the same as at the present day.

Before inquiring into the effects which the foreign exchanges have on our Money Market, we will state clearly what a foreign bill of exchange really is. When a foreign bill is bought, what is it that is bought? The transaction is simply this, that so much money is paid here for the right to so much currency of a certain country to be delivered at once, or at a given date, at a certain place, to the buyer of the bill or to his nominee. The bill itself is merely an order to pay, and the transaction resolves itself into bartering so much money of one country for so much money of another country, to be delivered at a specified place and time.

The value of the imports of the United Kingdom for 1901 was 522 millions of pounds, and of the exports 348 millions, together nearly 900 million pounds; and to understand how these huge transactions were settled financially, it is necessary to have some knowledge of the principles and customs of foreign exchanges. It is common knowledge that we do not pay gold for our imports nor receive gold for our exports. The imports are paid for mainly by the exports, the balance being made up of sums due to us for interest on capital invested abroad, for repayment of money invested abroad, and for freights, etc. *Some* gold, however, does enter into

the settlement of these transactions. This gold is sent from country to country, centre to centre, and further on in this chapter we shall see the causes of these movements and the effects arising from them.

There are certain technical terms used in connection with the foreign exchanges which must be clearly understood before it is possible to follow the various fluctuations in exchange rates, and the effect on our monetary position which such fluctuations produce.

We will consider one or two transactions between London and Paris as a practical illustration of these terms. Suppose a London merchant, A, owes to a Paris merchant, B, 25,000 francs. How can he pay that debt, and how much will it cost him to do so? He may either buy a draft on Paris and remit it to B, or instruct B to draw on him, or he may actually send gold. For the moment we will assume that he decides to send gold. How many sovereigns will A have to send so that B may receive the equivalent of the 25,000 francs due to him?

There are two ways of looking at a sovereign: one is that a sovereign *is* a sovereign, a coin of the realm, which everybody is pleased to possess; the other is as a piece of the precious metal which, by our English law, contains 7·988 grammes of standard

gold—standard gold, by our law, consisting of eleven parts pure gold and one part alloy. A franc, or rather a twenty-franc piece, can be looked at in the same two ways. According to French law, a kilo of gold, containing nine parts pure gold and one part alloy, is coined into 155 twenty-franc pieces. From these two sets of figures, by a simple calculation, we find that the pure gold in one sovereign is equal to the pure gold contained in 25·2215 francs; that is, that as regards intrinsic worth, one sovereign is equal to 25·2215 francs, and this exchange of 25·2215 (usually regarded as 25·22) is what is known as the "Mint Par" between England and France. A Mint Par represents the fixed intrinsic value of the currency unit of one country, expressed in terms of another country, which uses the same metal as a standard of value.

Thus when A sends gold to Paris to liquidate the debt, he must, on this basis, send sovereigns containing in the aggregate just the quantity of pure gold contained in 25,000 francs. This at the Mint Par of 25·22 is about £991 5*s.* 6*d.* But A must also pay for carriage and insurance of the parcel of coins, and these charges, we may assume, will amount together to 10 centimes per £, which, on the remittance in question, would amount to £3 18*s.* 7*d.* The total

cost will therefore be £995 4*s.* 1*d.*, which represents an exchange at the rate of about 25·12½.

Therefore if A liquidates his debt to B by sending gold, for each sovereign expended he only obtains the right to 25·12½ francs in Paris. This rate is called the "Export Specie Point," or "Export Gold Point," between England and France, and when the Paris exchange falls to this figure, we may expect gold to leave us for Paris, as gold is then as cheap a mode of remittance as bills.

Let us now reverse the position and assume that B in Paris owes A in London £1,000, and that he decides to send gold to pay his debt. What rate of exchange will result from this transaction?

To pay in gold he will have to send such a number of twenty-franc pieces that the gold in them shall be equal to the gold in 1,000 sovereigns; that is, as we have seen, 25,220 francs. But B will have to pay for carriage and insurance at, say, an average rate of 10 centimes per £1—that is 100 francs—making a total cost of 25,320 francs. This is an exchange of 25·32, and is called the "Import Specie Point" from France to England. When the exchange reaches this figure, gold should leave Paris for London. As a matter of fact, gold does not always come to us when the exchange is at this

figure, as the Bank of France interposes difficulties in the way of the export of gold. This has the effect of preventing gold coming in any large quantities unless the exchange rises above the Import Specie Point of 25·32. So we see that the Mint Par of London with Paris is 25·22 nominally —the Import Specie Point (gold to us) about 25·32, and the Export Specie Point (gold from us) about 25·12½.

In the same way the Mint Par and the gold points can be calculated with any foreign centre which has gold as the basis of its currency. With silver using countries these points cannot be fixed. Gold is with them a commodity only, and its value is measured in silver prices. With us and other gold using countries the reverse is the case as regards silver. Hence with silver using countries no common measure exists for determining the rates.

It is important for those concerned with this business to have firmly fixed in mind the Mint Par and Gold Points of London with Paris, Berlin, and New York; as of all exchanges these three are by far the most important, and have the greatest effect on our Money Market.

The figures relating to Paris have already been given. Those of Berlin are:—

Mint Par 20·43 (marks to a sovereign).
Import Gold Point about 20·52.
Export Gold Point about 20·33.

As with France, the export of gold from Germany is hindered by the Reichsbank. That institution, on the other hand, places facilities at the disposal of importers of the metal. For this reason gold does not come to us readily when the exchange rises to the figure at which we should otherwise expect it to come, and conversely, gold frequently leaves us before the rate has fallen to the nominal figure at which we expect it to go.

With New York the Mint Par is \$4·866 to £1, or $49\frac{5}{16}$*d.* to \$1;
the Import Gold Point is \$4·89½ to £1, or 49*d.* = \$1;
and the Export Gold Point is \$4·83½ to £1, or $49\frac{5}{8}$*d.* = \$1.

When an exchange is between the Mint Par and the Import Gold Point, it is said to be "for us," or "favourable"; and when an exchange is between the Mint Par and the Export Gold Point, it is said to be "against us," or "unfavourable."

The reasons for these terms are apparent on giving the matter a little consideration. If an exchange is

tending to such a figure that gold is likely to come to us, it is regarded as favourable, because if gold does come, it strengthens the Reserve of the Bank of England; and a strong Reserve means a low value for money here, which is generally considered to be good for trade. The reverse applies to the "unfavourable" exchange.

Having now arrived at an understanding of the terms Mint Par and Export and Import Gold Points, we will consider how and why rates fluctuate between these figures. As regards the merchants A in London and B in Paris, we have so far assumed that they have settled their indebtedness in gold. Such a mode of settling debts is unusual in international transactions; the ordinary course for A to follow would be either to buy a draft on Paris and remit it to B, or for B to draw a bill on A and sell it.

If the aggregate of debts between England and France exactly balanced, it can be assumed that in theory the exchange would stand at the Mint Par, because the total amount of drafts for sale would exactly equal the demand. But amid the multitudinous transactions of modern business we never are in a position to know when the mutual transactions of two countries balance, and the fluctuations in the rate of exchange are primarily due to the

relative degrees of urgency of buyers and eagerness of sellers—to a question of supply and demand.

Let us suppose that as a result of the aggregate dealings between France and England, France at one period owes us more than we owe her. Now it will be apparent that in the settlement of the transactions comprised in the aggregate, the merchants in France will find a difficulty in procuring sufficient drafts to settle all their indebtedness, and consequently there will be a likelihood of some of the merchants there having to send gold and bear the cost of remittance. Hence there will be competition among them to obtain what bills are offering—demand will exceed supply—and rather than be forced to send gold, buyers of drafts on London will be willing to pay more for them than the face value represented; that is, they will be willing to pay more than Mint Par.

For example, B in Paris owes A in London £1,000. He wishes to buy a draft for that amount, and expects to pay only 25,220 francs for it. He will find that there are many buyers who are competing for the available drafts, and to secure a remittance he perhaps may offer 25,250 francs, that is, an exchange at the rate of 25·25. Possibly he may obtain his draft at this price; but if buyers are urgent, sellers will take

advantage of the situation and raise their price still further. If the demand continue, the price may be raised to such a level that B will find that he can send gold without incurring extra expense. When this level is reached, gold is likely to pass from Paris to London.

Now we will suppose the contrary of this supposition; that is, that England owes more to France than France to England. Under these conditions a debtor in London will find a difficulty in procuring a draft on Paris. He may try to procure it at the rate of 25·22 francs, but he will find others competing for the available drafts, and he will be forced to buy at a lower rate of exchange, say 25·17. Competition will result in further reductions, until a point is reached when it is as cheap to send gold and pay the cost of transmission; that is, when the rate falls to about 25·12½.

Thus though one sovereign is always equal to 25·22 francs, coin for coin, yet the price of bills expressed in these coins will vary within certain limits according to demand and supply.

The exchange in London on Paris, or any other centre, will always tend to keep approximately level with the exchange at that centre on London. As an illustration, let us take an extreme case. Suppose we

quoted Paris at 25·20 and Paris quoted us at 25·30 A foreign banker in London, on seeing these quotations, would wire to his Paris correspondent to draw on him for, let us say, £1,000 and sell the draft, which would realise 25,300 francs. At the same time he would draw on his Paris friend for 25,300 francs and sell the draft in London, for which, at the rate of 25·20, he would receive £1,004 nearly. The Paris correspondent would be cleared, as he has drawn and sold a draft for 25,300 francs, and he has paid a draft drawn on him for the same amount; but the foreign banker in London has received £1,004, and only has to provide £1,000 to meet the draft drawn on him, leaving a profit of £4. He would not be the only one to perform this little operation, however, and the combined action of all such arbitrage dealers would promptly level quotations.

We will now turn our attention from theories to some actual facts, and examine how the business in foreign bills is conducted in London. The usual meaning of the term "Bourse" or "Exchange" is a place where merchants assemble to transact their business. We have our own famous Royal Exchange, although nowadays it is hardly famous for the meetings of merchants. It is a building which has survived its original purpose, but it is of interest

as being an historic relic of the place where the foundation of our great commercial supremacy was laid.

In the early part of the sixteenth century the London merchants met at regular times at some rendezvous in Lombard Street to transact their business. As their transactions and the number of the merchants represented increased, inconvenience arose, and in 1564 Sir Thomas Gresham offered to erect a suitable building for the merchants' meeting house if the City would provide the site. This offer was accepted, and the land where the Royal Exchange stands was purchased by a subscription of the citizens—a Mansion House fund. The edifice was duly built, and opened for business in 1571 by Queen Elizabeth. It was unfortunately destroyed by fire in 1666; rebuilt, and again destroyed in 1838. The present building was then erected, dating 1844, and the late Queen Victoria attended in state to open it, as is commemorated in one of the pictures exhibited in the building. The opening of the first building by Queen Elizabeth is the subject of another of these pictures.

The merchants in various trades used to assemble in groups, in corners and round the various pillars of the building; but it very soon became too small for

this purpose, and as the various groups waxed bigger and wealthier, they gradually deserted the building and erected exchanges of their own, such as the Stock Exchange, Coal Exchange, Hop Exchange, Metal, Wool, Corn, etc., exchanges. At the present day the Exchange is used only by the money merchants and a few dealers in some of the less important industries who occasionally meet there in the afternoon.

The money merchants hold their meetings in the Royal Exchange on Tuesdays and Thursdays, which days are called "post days." This term is a survival of the times when the foreign mails were despatched only twice a week.

The principals of the great foreign banking houses and a few brokers are the only persons who attend "'Change." As a result of the business then effected and the negotiations entered into, certain rates of exchange are arrived at as the ruling rates of the day. After the meeting the brokers publish a list of these rates, which is called the "Course of Exchange." A specimen "Course of Exchange" is here appended :—

LONDON COURSE OF EXCHANGE

TUESDAY, SEPTEMBER 8TH, 1903

	TIME.	PRICES AS NEGOTIATED THIS DAY.	
		FROM	TO
Amsterdam, Rotterdam, etc.	Short	12·06½	12·07¾
Ditto	3 Months	12·3¾	12·4½
Antwerp, Brussels, etc.	,,	25·37½	25·42½
Paris	Cheques	25·17½	25·18½
Ditto	3 Months	25·32½	25·37½
Marseilles, Lyons, etc.	,,	25·32½	25·37½
Zurich, Basle, etc.	,,	25·35	25·40
Hamburg, Berlin, and German Bank Places	,,	20·58	20·62
St. Petersburg	3 Months	24$\frac{12}{16}$	25$\frac{1}{16}$
Moscow	,,	24$\frac{15}{16}$	25$\frac{1}{16}$
Vienna, etc.	,,	24·17½	24·22½
Madrid	,,	34¼	34½
Other Spanish Bank Places	,,	34¼	34½
New York	Demand	48·6½	48·7*
Ditto	60 Days	48$\frac{11}{16}$	48$\frac{13}{16}$
Rome and Italian Bank Places	3 Months	25·40	25·45
Lisbon and Oporto	,,	42	42⅛

* This quotation is for £10, and is not now in use. The present mode of quotation is for dollars to the £ only—as 4·87.

The rates quoted in the table indicate the number of foreign coins given for one sovereign, with the exception of those on Spain, Portugal, Russia, and the United States. For Spain the quotation is the number of pence given for the peso, for Portugal the number of pence for a milreis, for Russia the number of pence for a rouble, and for America the number of pence for a dollar.

In London all rates are quoted *as they are quoted at the foreign centres on London*, with the exception only of Spain, where London quotes so many pence to the peso, while Spain quotes piastres to the £1; Russia, where we quote so many pence to the rouble, and Russia so many roubles to £10; and New York, where we quote so many pence to the $1, while New York quotes so many dollars to the £1. With regard to the New York quotation, however, London now as frequently uses the quotation of dollars to the £1 as pence to the dollar.

Except when otherwise stated, the rates quoted in the "Course" are for bills having three months to run, or in technical language, they are the rates for the "Long exchange." Rates quoted as "cheque," "sight," or "demand," are known as the "Short exchange."

The rates of the Long exchange are arrived at as

follows: We will suppose that a merchant in London has to pay a debt in Paris of 25,000 francs, and for simplicity we will assume that the sight rate on Paris is 25. If the merchant buys a sight draft on Paris for 25,000 francs and remits it to his creditor, it closes the transaction, and the remittance has cost the merchant £1,000.

But if instead of buying a sight draft at this rate he bought a three-months draft, what would be the result? When he sent this draft to his friends in Paris they could not credit him with it at once, and so close the transaction, as they would then be out of their money for three months. So the parties in Paris to whom the draft was remitted would discount it with their banker, and credit the London merchant with the *proceeds only*. He would also be charged for a bill stamp, and in addition, he would be liable for any contingencies which might arise, interfering with the due payment of the bill, until payment was actually made. So instead of the London merchant being credited with 25,000 francs, he would only be credited with 25,000 francs *minus* discount at the French market rate, say 4 per cent. for three months = 250 francs, and *minus* the bill stamp = 12·5 francs, that is 24,737·5 francs. Moreover, he would be under liability on his endorsement of the

draft until its maturity, and for this he ought to receive some consideration. Consequently when the London merchant buys his bill, if a three months bill is offered him instead of a sight draft, he demands an allowance in the rate sufficient to cover interest at the foreign market rate, plus stamp, plus allowance for contingencies. And the rate for such a transaction will be arrived at as follows: First, as the presumed sight rate is 25, to this must be added three months' interest at the foreign market rate (say at 4 per cent.) on 25, which is ·25, bill stamp at ½ per mille must also be added, say ·01¼, and an allowance for risk which we may take at ·00¾. Thus the rate for such a three months draft would be $25 + {\cdot}25 + {\cdot}01\frac{1}{4} + {\cdot}00\frac{3}{4} = 25{\cdot}27$.

Now at this new rate, or "long rate" of 25·27, let us suppose our merchant to buy and remit a draft of 25,270 francs for £1,000. His friends in Paris will then credit him with the full amount of his debt, and a little more, being the allowance for risk.

It must be distinctly borne in mind that adding interest, etc., to the "sight" rate to obtain the "long" rate only holds good when we are dealing with rates quoted in *foreign currency*, and that when we deal with rates quoted in *sterling* we must deduct these allowances from the short rate instead of adding them.

It will be noticed that two prices are quoted

opposite each centre in the "Course of Exchange." These prices do not represent the figure at which bills can be bought and sold, like Stock Exchange quotations. As regards the "long" rates, the two prices indicate the price ruling for different classes of paper, *bank* paper and *trade* paper. Bank bills will discount abroad at a lower rate than commercial bills, as with us; and therefore in calculating the long exchange on bank bills a smaller amount has to be allowed for interest than with commercial bills. Hence, of these two quotations the lower rate is for bank paper, and the higher rate for trade paper.

As regards the two rates for short quotations, the explanation is that "demand" bills are understood to mean any draft having up to ten days to run. A bill which is not due for ten days is, of course, not worth as much as a draft due at once. The standing of the parties to the draft also affects the quotation to some extent.

There is still to be considered the important question of how the Foreign Exchanges are connected with our Money Market, and how they influence and are influenced by the Bank Rate and the value of money in England.

It is evident that if the market rate of discount for first-class paper is higher in London than in Paris, a

French banker will earn more interest on his money if he buys London bills than if he buys Paris bills. But when dealing with foreign bills, "exchange" comes into the question as well as interest. This further factor introduces an element of speculation which is not present with the home article.

Suppose, for example, the Paris market rate to be 3 per cent. and the London rate 4 per cent.—the cheque exchange standing at 25·22 and the long rate in Paris of bills on London consequently at about 24·97. A banker in Paris buys a three months bill *on* London for £100, paying for it 2,497 francs. When the bill falls due it can be sold as a sight draft. If the *short* exchange remains at 25·22 it will realise 2,522 francs, showing 25 francs as the interest for three months on the amount invested, that is at the rate of 4 per cent. per annum, as against 3 per cent. per annum, which is the rate which would have been earned in France for these three months. If when the bill matures the short exchange is, say, 25·12, for the £100 draft the interest will be 15 francs only, or at the rate of 2½ per cent. per annum. On the other hand, if the short rate is 25·32 when the draft matures, the interest will be 35 francs, or about 5½ per cent. per annum.

Thus there is a wide fluctuation in the interest that may be earned on a foreign bill. When the

French exchange is low, and the rate of interest ruling in London is above that ruling in Paris, there is consequently an incentive for a French banker to invest in English bills; for not only is the rate of interest greater than would be obtained in Paris, but the chances are in favour of a rise taking place in the rate of exchange, which will, of course, be to his advantage.

From this it follows that when our *interest* is *above* that ruling at foreign centres, and the exchanges on us are *low*, a heavy investment demand from continental bankers sets in, in order to take advantage, not only of the higher interest obtainable in London, but also of the possible profit on the exchange. This demand will not only have the effect of stopping a further fall in exchange rates, but will often send them in the opposite direction. If, from some cause or other, the rate remains low, the continental holders of our bills will keep them until they become due and so earn the higher interest. If the rate rises to any extent, certain holders will at once begin to sell, as they will have earned their interest for the time they have held the bills, and seeing their way to secure a certain profit on the exchange, they think it well to take this, and employ their money in some other centre which promises more profit.

We can now appreciate the value and importance of this investment business. When our interest is high and exchanges low, it indicates that we are having more or less of a money squeeze at home, and the low exchanges threaten an export of gold, which would make matters worse. The continental banker then steps in for his own profit, and benefits us at the same time, as, by his action, he tends to support or raise the exchange, and thus to stop the outflow of gold. He also places some of his capital at our disposal, as continental bankers, when investing in foreign paper, usually only buy first-class bills. There is only a limited amount of these bills for sale on the Continent, and so the continental bankers adopt the course of instructing their London representatives to buy what they require, and remit funds to cover the purchase.

When exchange rates rise and point to a possible inflow of gold to London, continental bankers cease their investments and realise their holdings, thus stopping the rise of rates and, for the time at any rate, the possible inflow of gold.

Thus the investment business in foreign bills acts really as a pendulum to the exchanges, steadying the fluctuations and having a most important influence on the export and import of gold.

We are now in a position to understand how it is that a change in our Bank Rate is so clearly allied with the question of foreign exchange. If we find that exports of gold threaten us, which may reduce our "Reserve" below the figure at which it is desired to maintain it, the Bank of England will increase its official rate. If this increase in rate is then followed by the Market, or, if the Market lags behind, steps be taken to compel it to follow suit, we hold out the advantage to the continental bankers of an increased interest over what they can earn at home, and a prospective profit through a possible rise in exchange. Then, in all probability, their purchases of London bills will gradually have the effect of raising the rate and stopping the outflow of gold.

CHAPTER XIII

THE MONEY ARTICLE OF THE PRESS

THE Money Article of the daily Press is regarded so much as a part of the usual information provided for the public, that few readers pause to consider the large amount and far-reaching character of the information which is supplied therein: information gathered from all quarters of the globe—sifted, summarised, and placed before the public in a concise form. The amount of practical and useful knowledge derived from a perusal of Money Articles depends entirely upon the reader. Without some knowledge of the Money Market and financial matters generally, the articles resolve themselves into a mere record of the rise and fall in price of various commodities—money, bills, stocks, and shares. With knowledge, however, these articles may be said to represent to the reader a mirror, in which the affairs of the whole world are pictured, though in a somewhat mercenary manner.

The genesis of the Money Article was about the year 1825. Previous to that date a few of the leading papers published a list of the prices of the stocks and shares then dealt in on the Stock Exchange, but practically nothing further than the list appeared. About the above-mentioned year, however, public interest in Stock Exchange matters received a great stimulus, and the editors of certain papers then commenced to devote more attention to the matter than they had previously done. As the subject gradually became of more and wider interest to the public at large, the papers devoted more and more attention to it. The advent of limited liability companies enormously increased the number of persons interested in Stock Exchange matters, and the Money Article then became an important and integral part of every paper of standing. At the present time, as previously noted, the Money Article really reflects the financial matters of the whole world, and any event which causes a change in the natural or political conditions of any country the world over is sure, sooner or later, to have its effect noted in one of the paragraphs of the Money Article.

There are two ways of reading a Money Article. The first, and probably by far the most popular method, is merely to glance at, or "skip over," the

information respecting the condition of the Money Market, the price of money, the discount of bills, foreign exchanges, Bank Return, etc., and to turn to the supposedly more interesting subject of the fluctuations in prices on the Stock Exchange, and especially of the prices of those securities in which the reader has a pecuniary interest.

The other method of reading these articles, and certainly the most profitable method, is to read thoughtfully *all* the information, and to note the connection of cause and effect in relation to the various items mentioned; in fact, to read the articles as a homogeneous whole, and not simply to dip into them here and there; and the reader who so reads his Money Article will be surprised to find what an insight into the present and, to a certain extent, the future financial position he acquires thereby.

The City Editor of a paper has a vast amount of information to supply to the public, and a limited amount of space in which to present that information, and the result is that these articles are usually decidedly "terse"—not to say abrupt—in style: a fact is briefly stated, and the probable effect of such fact is added, though no information is given as to why such an effect should result from such a cause, which is left to the reader to fathom out as best he can.

Money Articles may be roughly divided into two sections: the first deals with the Money Market proper, the foreign exchanges, gold movements, etc., and the second with Stock Exchange matters. These two sections may appeal to somewhat different classes of the community; but the connection between them is so intimate, and they act and react on each other so frequently, that they cannot be dissociated. The first section of the article more nearly affects the subject-matter of this book than the latter portion, which is amply dealt with in another book of this series.

Money Articles almost invariably commence with a paragraph which is really a general summary of the events which have transpired in the Money Market on the day of writing. The first paragraph, though consisting of only a few lines, often teems with information to those that can read it aright. Nearly all the subjects with which it deals have been dealt with in the course of this book, and therefore it will only be necessary to enumerate them here.

The condition of the Money Market is first noted in reference to the supply and demand of "call" and "short money," as between the bill-brokers, the banks, and the Bank of England; the rates are quoted at which money was lent at "call," "over-

night," or for "short periods," and mention is made of any transactions in this market entered into by the India Council. Passing on from this, any facts are mentioned which, on the day in question, *have* had, or on the following day *will* have, any important bearing on the position of the short loan fund. These items comprise reminders of the falling due of any instalment on large new public issues, the payment for or repayment of Treasury, India, or Corporation bills, etc.

The question of discount rates is then dealt with, and a note is usually made as to whether or no the banks are "working"; that is, whether the banks are buying bills from the brokers, or refraining from so doing. The paragraph then usually concludes with a reference to exchange rates.

The article then proceeds to note any import or export of gold which has taken place on the day in question, and any variation which may have occurred in the price of gold. Importers of the metal know that they can always sell their gold to the Bank of England at the minimum price of £3 17*s*. 9*d*. per standard ounce, and therefore the price never falls below this figure. If there is any foreign demand for gold, the exporters will bid above this price, and secure what is offering, unless

the Bank of England raises its buying price, as it sometimes does in times of stringency. It is of interest to note the origin of imports and the destination of exports of gold; and, at the same time, to follow the movements in the exchange rates of London with these places of origin or destination. The action of the Bank of France and of the Reichsbank in retarding exports will frequently become visible in these figures, as will also the action of the latter institution in facilitating imports of the metal into Germany. A note will at times appear that so much gold has been sold for Germany at such a price, and if the foreign exchange table in the same article be referred to, it will often be found that this gold has left us for Berlin in spite of the exchange being well above the nominal export specie point.

The expression that "the Bank bought so much gold to-day" appears to cause difficulty in some minds, in that some people cannot understand how the Bank benefits by buying gold. "What can be the use of the Bank buying gold?" they say. "It must give gold for gold, which won't alter its position in the slightest!" This matter is a very simple one really, and explains itself with a little thought. The usual procedure of dealing with an import of gold

is for the importer, or his agent, to hand the gold to the Banking Department of the Bank of England, which *credits* him for the value of the gold. Of course, if the importer were then to draw out this amount in gold the Bank would not be benefited, but this does not happen under any ordinary circumstances. The Banking Department passes the gold on to the Issue Department in exchange for notes, and the extent to which the Bank benefits is shown in the ensuing Return, when "Other Deposits" will be increased, owing to some account having been credited for the gold received, and on the other side of the account "Notes" will be so much higher; that is, the Reserve and Ratio will both be increased. The figures of the Issue Department will be increased on each side by the amount of gold received and notes issued.

The question of silver is then dealt with in the article. This question is not now of such importance as was the case a few years ago, when the bi-metallic theory was so much to the fore. The position of silver is very different now from what it was up to quite recent years. For many centuries previous to about thirty years ago, the price of silver as compared with that of gold was about as 15 is to 1; in other words, an ounce of silver was worth about

5*s*., and an ounce of gold about 75*s*. to 80*s*. This state of things has now entirely disappeared, however, and we find silver fluctuating rapidly and extensively in price—having in the course of the year 1902 been as low as $21\frac{9}{16}$*d*. per ounce.

The reason for this fall in the price of silver is not far to seek; supply has largely exceeded demand. Several countries which had been large consumers of silver for currency purposes have, during the last thirty years, thrown over their silver system and adopted gold in its place, as a standard of value. This, of course, largely decreased the demand for the metal, and in addition it threw a large amount of silver out of circulation and on to the market. The supply of the metal has also been largely increased, owing to extensive discoveries of new mines, and to improvements in the method of mining, which have made it possible for mines of a low grade of ore to be worked at a commercial profit.

The paragraph in the article relating to silver is of chief interest to those who have commercial transactions with silver using countries, and also to those who are interested in companies whose business is conducted in such countries. These companies earn their revenue in silver, but pay their dividends in gold, in addition to often paying for much of their

material in gold. Therefore the rate of exchange between such countries and London, which rate is of course subject to the price of silver, is of material interest to the holders of such stocks.

Ths price of the Mexican dollar is frequently noted in the "silver" paragraph of Money Articles. Mexican dollars circulate freely on the coast of China, in spite of many efforts which have been made to supplant them. When the dollars arrive in China the merchants who receive them put their "mark" on each coin, which thereafter circulates freely; the merchants' "marks" being looked on by the populace as a proof of genuineness. In London, Mexican dollars are dealt in by weight, and as they are coined in silver nine-tenths fine, their price should consequently be a little less per ounce than the price of bar silver; but demand sometimes exceeds supply, when the price of the coins rises somewhat considerably above their intrinsic worth.

The Indian price of silver is also noted in the article: this price refers to the number of rupees which have to be given for one hundred tolas of silver; the tola being an Indian weight equal to ·375 ounce, and the silver being about nine-tenths fine.

Up to this point the information given in Money

Articles is of daily occurrence, and attention is then turned to various items of intelligence according to the day of the week or month. For instance, the day after 'Change is held in London, a paragraph is inserted dealing with the various alterations which have been established in exchange rates since the previous post day, and the "Course of Exchange" is usually printed, more or less in full. On Friday mornings the Bank Return is published, and the City Editor adds his own notes on the same, calling attention to, and explaining as best he can, any alterations which have occurred since the previous return. On Friday also, the return of the Bankers' Clearing House makes its appearance.

On Wednesdays and Thursdays the traffic returns of various railways are published. These returns are of interest as exhibiting the state of trade throughout the country as a whole, as well as the position of individual lines. In considering railway traffics, and comparing them with previous results, care must be taken to bear in mind any alteration which may have taken place in the price of labour, coal, or material; as an increase in gross profit may be quite offset by an increase in any one of these items, and *vice versâ*. It is also of interest to note that an increase or decrease in the *gross* earnings of

a railway, the chief business of which consists of passenger traffic, has far greater effect on the *net* earnings than does a similar increase or decrease have on a line the chief business of which consists of goods traffic. Passenger trains run whether they are full or empty, and therefore an increase in the takings from passengers means, very largely, so much more net earnings; whereas goods trains usually run only when traffic offers, and therefore extra traffic means considerable extra expense. In considering the probable results of railways doing business in silver using countries, the influence of the price of silver must not be overlooked.

On the seventh day of each month the Board of Trade publishes a return showing the exports, imports, and re-exports of goods for the previous month. This return is summarised in the following day's Money Article, and when this is read in conjunction with the Clearing House Return and the Traffic Returns, the three together form a very good barometer of the state of our trade. In studying the figures of the Board of Trade, and comparing them with previous returns, it is important to remember that *values* only should not be considered, but *quantities* as well as *values*; we may have imported considerably more of a certain commodity,

but paid less for it, or imported less and paid more.

In many articles two tables relating to the foreign exchanges appear daily; one of these is a table of the rates of interest for money ruling in the principal financial centres of the Continent, and the other is a table of the exchange rates prevailing in foreign centres for drafts *on* London. The first of these tables is of use as providing one of the factors necessary to calculate the "long" rate from the "short" rate; it is also of use as being a guide to the comparative value of money in various centres, and thereby indicating the likelihood of foreign bankers investing their funds in London bills, or of withdrawing such investments. The second table indicates the movements in rates which are taking place on the Continent between our "'Change" days, and it is of use to those persons who have considerable sums to pay to, or receive from, foreign centres. As was noted in the chapter dealing with the foreign exchanges, the rates between any two given centres always keep nearly on a level, but there is at times a slight variation. Advantage can be taken of this variation by persons having transactions with such centres, and this table affords necessary information in the matter.

The foregoing items of news comprise the Money Market portion of the article, and attention is then given to the Stock Exchange portion. This portion is divided into several paragraphs, each one of which deals with a special and well-recognised class of stock, or "market," as it is called.

First we have the paragraph dealing with the "gilt-edged market." This market comprises securities of, or guaranteed by, the British Government (Consols, local loans, etc.), Bank stock, and colonial and municipal issues. The whole of this market is largely under the influence of the price of money, and, at present, of excess of supply over demand. The supply of Government stocks has, of course, been increased owing to the requirements of the late war, which led to a further issue of Consols, in addition to the creation of the War Loan and Transvaal Loan. In addition, a very large amount of colonial and municipal loans has been offered to the public during the course of the last few years. These issues have been far in excess of the demand, with a consequence that the market has been glutted with securities of this class, resulting in an all-round depression of prices. This depression has been deepened by the knowledge of the many new issues which are only

awaiting a favourable opportunity to be launched on the public.

The next paragraph in most Money Articles deals with the "Foreign Market"—Spanish, Turks, Russians, Tintos, etc. In this section securities are dealt with which have a more or less international character, and in which dealings on foreign stock exchanges have often considerably more importance than the dealings on our own Exchange. Hence this section is not so much under the influence of the price of money as it is under the influence of the attitude and condition of foreign centres, especially those of Paris and Berlin.

Home railways are then dealt with, and then American rails, which latter are, of course, largely under the influence of New York and its magnates. Then comes a paragraph dealing with colonial and foreign rails, which are largely under harvest influences, and the internal condition of the country in which they do their business. Then follow paragraphs on the miscellaneous and industrial sections, and lastly a paragraph on the mining market.

The miscellaneous and industrial section is chiefly notable for the large number and different character of the securities there dealt in, comprising the shares of banks, breweries, insurance and finance companies,

iron, coal, and steel concerns, waterworks, etc., besides the shares of numerous manufacturing and catering companies. Much speculation exists in certain classes of these shares, but it is a noticeable fact that the issues of many of the sound industrial concerns have withstood the recent severe wave of depression far better than have many securities which are supposed to be of a considerably higher status.

Following this there usually appear dividend announcements, reports of company meetings, and a number of miscellaneous notices. Although these notices mostly explain themselves, and are of interest only to persons connected with them, yet one or two items which appear from time to time are of somewhat more general interest. It is of frequent occurrence to find in this portion of the article a notice that "tenders for Treasury Bills will be received at the Bank of England on such a date."

Treasury Bills constitute a Money Market and not a Stock Exchange security, and they belong to the unfunded debt of this country. They were first issued in 1877, and were promptly recognised, both in our own and foreign markets, as being bills of the highest possible class. These bills are issued from time to time to suit the necessities of the Government; they have a currency of three, six, nine, or

twelve months, and are of great assistance to the Chancellor of the Exchequer in enabling him to regulate the finances of his department.

Treasury Bills are always issued by the tender system, and those persons who wish to acquire some of these bills must make their application through a London banker. The tender must state how much per cent. will be given for such an amount of bills, and those who tender at higher figures will, of course, obtain an allotment in preference to those tendering at lower ones.

Besides Treasury Bills, several other classes of security are, from time to time, issued by tender; for example: India bills, London County Council bills, Corporation and Colonial stock. This system of issue is not a popular method so far as the general public are concerned, as it is not properly understood; and when the public do endeavour to obtain investments in this manner, they often make ludicrous and expensive mistakes by tendering at a figure far above what would easily obtain an allotment.

Another item of interest which appears among these "notices" is the notice of issue of stock at *fixed prices.* Such notices appear plain on the face of them; but, on comparing the price of issue with

the market price of similar stocks, care must be taken not to overlook the fact that very frequently certain allowances have to be taken off the nominal price of issue. These allowances are in respect of the stock being only paid up by instalments, while interest is often paid on the full nominal amount; and often, in addition, a full six months' interest is paid only three or four months after the issue; besides which the stock can frequently be paid up in full at any time, under rebate. Such considerations as these should always be borne in mind, as they have a material bearing on the *real* price of issue.

The article concludes with a list of "closing prices," and of "business done" on the Stock Exchange on the day in question. The closing prices are estimates only, supplied by certain members of the House, and though affording a very good guide to the course of prices, they cannot be relied upon for any out-of-the-way securities—actual dealings in which may be impossible at the prices quoted.

From this brief examination of the usual contents of a Money Article, the large amount of information embodied in such becomes apparent, and also the necessity for a certain amount of technical knowledge to enable a reader to grasp, and make full use of the information there placed at his service.

CHAPTER XIV

CONCLUSION

IN the course of this book we have briefly surveyed the rise and development of the banking system of England. We have studied the establishment and growth of the Bank of England, the gradual elimination of the private banker, and the wonderful development of joint-stock banking, and we have noted the causes which led to London becoming the financial centre of the world, and also the various factors which constitute our Money Market.

From a weak beginning we have seen our system of finance develop into a mighty machine; but we have seen that, although it is mighty, it is a machine of very delicate construction, and that it needs the most careful attention on the part of those connected with its working. A breakdown in one of its parts may mean wreck for the whole concern, and bring with it, not only unparalleled

individual distress, but actual danger of an acute form to the whole nation.

The weakest spot of our system arises from the custom of the cash reserves of the bankers being kept with the Bank of England, that is, the one-reserve system. The total deposits held by the banks of the kingdom may be roughly estimated at one thousand million pounds, and practically the whole of this vast sum is repayable in cash on demand. But banks conduct their business on the law of averages, assuming that the demands for cash will be met by the deposit of cash—that what is paid out to one set of customers will be paid in by another set; and, while keeping sufficient till money to tide over the variations of demand and supply from day to day, they maintain no other reserve of cash, beyond the balance at the Bank of England,—or with a London agent, through whom such balances are in effect passed on to the Bank of England. Thus the Bank of England is the reservoir from which all banks expect to be able to draw cash in time of need.

When we turn to the Bank Return, what cash do we find is retained to meet such a heavy contingent liability? In the figures of the "Return" given in chapter vii., the "Reserve" stands at about twenty-five million pounds only; and with regard to this

Reserve, it must be remembered that the Bank is peculiarly open to foreign demands in addition to home demands. Such a reserve is slender, to say the least of it, and the strengthening of the "Reserve" to a figure more in keeping with our increased liabilities is, or should be, constantly before the authorities who have the control of our banks. This matter will have to be faced some day, and the longer action is delayed the more difficult will it become to grapple with it.

Various schemes for increasing our reserve have been put forward from time to time: one suggestion was that banks should retain a safety reserve of gold in their own keeping; another that a bankers' bank should be established, to hold the reserves of other banks in place of the Bank of England; a third, that each bank should maintain a larger balance with the Bank of England, on the understanding that that institution should increase its reserve in respect of such increased balances. These schemes have each their advocates and opponents, but with each the result to the banks would be a loss of profit, for each would involve more money lying idle. This loss of profit is at the root of the whole difficulty.

This brings us to consider the question of competition among bankers, which at present is very keen, and which quite conceivably may lead to

dangerous results unless kept within reasonable bounds.

The tendency of the time is towards the absorption of the smaller and weaker banks of the country by the large joint-stock banks. In itself, this is not an undesirable feature, in that it places the banking system, as a whole, on a sounder footing. Another feature is the establishment of branch offices throughout the length and breadth of the land. This gives facilities for capital to flow readily from one part of the country where it may be in excess, to another where it is in demand.

The joint-stock banks, however, are keen competitors among themselves, new branches being established wherever the possibility of securing new business exists, or where existing connections are threatened by the incursions of some other bank.

This multiplication of banking offices is of decided convenience to customers; it saves them the trouble of sending long distances to pay in, or to draw wages, etc.

In the race for business, however, rates are cut down to attract custom, and risks are perhaps undertaken which would not be entertained if competition were not so keen. These risks may not be large individually, but collectively they may amount to

a large sum. They possibly tend to lock up resources in *one class* of security, which, as we have seen, is a source of danger. This is especially the case in new and growing districts, where much accommodation is asked for on the security of house property, and for the purpose of developing new estates. There is, in fact, a growing tendency at the present day to transfer to banks business which formerly went to building societies; and if this system is encouraged, it is likely to result in a large portion of a bank's advances becoming of a fixed nature and unavailable in case of need.

Mr. F. E. Steele, in a lecture recently delivered to the students of the London Chamber of Commerce, called attention to another danger resulting from undue competition. He said:—

"There is another phase of competition which should be touched upon. This phase I do not remember to have seen specifically dealt with in treatises on banking. I refer to the growing tendency on the part of banks to ear-mark, for the benefit of particular depositors, securities which should form a free asset; a security to the general body of its depositors. You will find now in some balance sheets, either in the investment column or as a foot-note, that a certain portion of the bank's investments

are held for public bodies, such as county councils, borough councils, corporations, etc. In order to secure the accounts of these bodies the banker hypothecates to them certain securities, such as Consols, which would otherwise be held for the benefit of its depositors in general. This tendency to tie up assets which should be free should be narrowly watched by the public, and carefully controlled by bankers. That it should be resorted to in some cases seems inevitable. It is done by some of the best and soundest banks. But it is a course which should be resorted to as little as possible."

In conclusion, we will turn from the question of the Money Market itself to the army of individuals who spend their lives in the service of the various institutions forming the Money Market. By far the largest number of these individuals are connected with our various joint-stock and private banks. It is commonly thought that the life of a bank clerk is an easy one. Jerome K. Jerome, in his amusing book *Three Men in a Boat*, in referring to the occupation of his friend George, says, "He sleeps in a bank from nine till four, when they wake him up and put him outside." Common ideas, however, are frequently not quite correct, and though certain members of the fraternity, who happen to be situated

in country and suburban districts, do not suffer from overwork, yet as regards those connected with London and the large centres of industry, their life is an arduous one,—often tedious in its sameness,—the hours of work are not short, and the remuneration, although adequate, is not generally on the scale that some time ago was popularly believed to be the happy lot of the bank clerk. Still, one's life is what he makes it, and the idea embodied in Napoleon's saying—that every soldier carried in his knapsack a marshal's bâton—is equally true of the banking profession.

Every junior on entering the service of a bank has before him the prospect of ultimately rising to occupy a position of importance and respect, even to the position of general manager of his bank, if he so equips and conducts himself as to be fit for and worthy of such promotion.

The facilities and inducements to self-improvement placed before bank clerks of the present day are much greater than in bygone times. Many classes are held and lectures given dealing with banking subjects. Examinations are held, and many banks recognise and reward the success of their clerks at these tests of knowledge. Technical knowledge, however, is not everything; common sense, good

judgment, tact, and a cool head are also necessary in order to become a successful banker or financier, but these qualities are of much more value when combined with sound and good technical knowledge.

Greatness is not thrust upon any bank clerk, but it is in the power of all, if they will, to achieve it, to a greater or less degree.

APPENDIX

THE GOLD RESERVE

SINCE the remarks concerning the Gold Reserve were written (chapter xiv.) much interest has been aroused in the matter by a suggestion made by Mr. J. Herbert Tritton, the President of the Institute of Bankers.

At the opening of the last session of the Institute (November, 1903) the President, in his inaugural address, after referring to many current and important topics, passed on to the subject of the visible gold reserves, and made the following novel suggestion. By Mr. Tritton's courtesy his remarks on this matter are here reproduced in full.

"VISIBLE GOLD RESERVES

"The ever-pressing question of this country's visible reserves of gold, quiescent during the war, is again attracting attention. Theoretically, everyone would admit that larger reserves of gold in this country are desirable; many would go further and say necessary; but any, even the smallest, step in the direction of action is at once barred on the ground of expense. At whose cost is the reserve to be held? £15,000,000 at 3 per cent. is £450,000 a year, and this must almost inevitably come

out of somebody's pocket. Bank of England stockholders and ordinary bank shareholders would be mulcted, or would think they were, to the extent, say, of a second income tax of 1*s.* in the pound on their dividends. Of course, the question is, in its essence, of national importance, but the Treasury of this country never allows itself to be influenced by considerations of this character—nor, indeed, have the English people for the last fifty years expected either Government help or Government interference in their financial or commercial affairs. Pardon the interjection, but I, for one, say long may this country be not only self-reliant, but free; free to trade as each member of it shall choose, unshackled and uninfluenced by Government restrictions or Government encouragements! We may, perhaps, cherish a faint hope that the new Chancellor of the Exchequer may realise that he has taken with him from the Post Office, liabilities as a banker, £144,605,088 in respect of Post Office Savings Banks, and finds in his new office a further sum of £52,505,081 in respect of Trustee Savings Banks, making together £197,110,169, liable to be repaid in gold; and realising this as a banker, may be less obdurate than his predecessors. But it would not be wise to expect much from Downing Street: if the thing is to be done we must do it ourselves. That a solution of the question is supremely necessary I am convinced, however great the initial difficulties may be; and that it is not beyond attainment if the best energies and the best brains of the banking community be devoted to it, I am also persuaded. Mr. R. H. Inglis Palgrave gives in his new book, *Bank Rate and the Money Market*—a book

which every banker should possess and read—page 104, the following table :—

	Capital, Deposits, and Circulation.	Average Reserve, Bank of England.	Proportion per cent. of Reserve at Bank to Liability as of all Banks to the Public.
1872	£584,000,000 ...	£12,100,000 ..	2·06
	Deposits, Current Accounts and Circulation of all Banks publishing accounts in the United Kingdom were :—		
1894	£721,400,000 ...	£25,800,000	3·58
1895	. 794,600,000 ...	29,900,000	3·75
1896	. 797,700,000 ...	34,600,000	4·33
1897	. 816,400,000 ...	25,100,000	3·07
1898	. 838,300,000 ...	22,900,000	
1899	. 869,300,000 ...	21,200,000	2·44
1900	. 889,600,000 ...	21,400,000	2·41
1901	. 888,100,000 ...	24,046,000	2·71
*1902	. 904,100,000 ...	24,166,000	2·67

"The Bank of England reserve, which constitutes the only real reserve of the country, is shown here in its true light from our present point of view. A further outside reserve of, say, £15,000,000 would only, it is true, serve to restore the proportion to that of the year 1896, but it would ensure the present maximum becoming, in effect, the future minimum, and here would be a great gain in an extra sense of security in troublous times. Should a gold panic at any time seize upon the public, it would matter little whether the ratio of Bank of England reserve to the

aggregate liabilities were 2·50 or 5 per cent., suspension of cash payments would ensue. A credit panic, as distinguished from a gold panic, can usually be assuaged by a suspension of the Bank Act and an overissue of bank-notes. A further object of an increased gold reserve is that not only the periodic and well-recognised, but the unexpected and perhaps heavy withdrawals of gold may be met without recourse to violent measures such as those to which the market is too often subjected. If this were clearly seen to be not only the intention, but the practical working of the fund, an objection which, I admit, is of great weight would be fairly met, and minor objections would almost disappear.

"The objection to which I refer is this. Gold is meant to circulate, not to be hoarded, and any proposal permanently to withdraw such an amount as £15,000,000 from circulation and, as it were, entomb it again in the bowels of the earth, stands self-condemned. No such entombment is suggested, as far as I know, but the formation of a fund for use—a fund which, on occasions, would pass into circulation—international, if not national—and would have a steadying effect on the pulse of the Empire, the Bank of England rate. How can we set about securing it? Let us glance at the tabulated bank balance sheets of the country. From which of the items on the assets side could such a sum be withdrawn? Loans and discounts? No. Investments? No. Buildings? No. Money at call? No. Cash in hand and at Bank of England? This, *ex hypothesi*, is the item to be increased. The reasons I need not give, but it appears tolerably plain that no plan involving a

permanent diminution of any item on the asset side would meet with a favourable reception from practical men. Is it possible, if these items cannot be conveniently decreased, to obtain the amount by a fresh creation of credit, an addition to loans and discounts, and an equivalent addition to the other side of the account?" Please understand that I am considering the case quite apart from the Bank of England.

"Here I am directly and once again challenging critics, who do not agree in my view of the non-elasticity of the Money Market, to show how, in their view, the alleged elasticity of the market may be utilised to produce a fund of £15,000,000. My contention is that only by the increase of the note issue or by increase of capital can it be reached. Suppose the bankers were authorised to issue £15,000,000 of £1 bank-notes. How could these be kept in circulation unless they were legal tender? Of what use would they be if they took the place of gold in our tills? This plan, under which alone could credit be created, would be futile to attain our end. There remains only the creation of new capital, unless our friends, whom I am challenging, and to whom we are looking to give us a discussion which cannot fail to be interesting under the auspices of Mr. A. C. Cole, who has undertaken to read a paper on 'Notes on the London Money Market,' can show us some adequate alternative. If each bank of the kingdom increased its paid-up capital 20 per cent. by an issue of a Three per cent. Preference Gold Stock, the fund could be attained. The proceeds should be devoted in each individual case to the acquisition of a correspond-

ing amount of gold, in addition to present holdings, and this gold should be deposited at the Bank of England, but not merged in the Bank figures, so as to stand week by week intact, and shown under a separate heading in one aggregate, though, of course, the absolute property of each bank in detail. Carefully thought out arrangements whereby, under a joint committee of the bankers and the Bank of England, whenever occasion arises, a percentage of each holding should be transferable to the credit of each bank in the books of the Bank of England should be made, the gold thus forming an addition to their reserve until again withdrawn and added to the Bankers' Gold Fund."

Needless to say, this suggestion, coming from such an authority, caused much comment in monetary circles, and was generally received as a valuable contribution to the various schemes having for an end the settlement of this important matter.

In certain quarters, however, the scheme was held to be an impracticable one; and at a subsequent meeting of the Institute of Bankers, Mr. Cole, a director of the Bank of England, spoke as follows:—

"As regards the proposal to increase the capital of the banks, my reply is that the floating of a loan in this market of £15,000,000, or of £100,000,000, will not add one single golden sovereign to the bankers' cash reserves.

"We can only increase our stock of gold in this country by getting it from abroad. To do that we must offer to

the holders of gold abroad something that they will take in exchange for their gold.

"A loan in this market to increase the capital of the banks, to be subscribed for by the public who have deposits with them, is merely transferring a liability now existing on the part of the bankers to the public, from their depositors to their shareholders. The only way the bankers can increase their cash in hand, or balances at the Bank of England, is by following the method now pursued, namely, calling in their short loans so that the market has to borrow at the Bank of England. To put their position permanently on a sounder basis they must agree that instead of calling in their loans temporarily, they must all keep permanently larger balances at the Bank of England. Then the gold reserves of the country will be increased, provided that the Bank of England maintains its usual ratio of cash to liabilities. Taking that as 45 per cent.—the average proportion for the last twenty years ending 31st December, 1903, has been 46·6 per cent.—a permanent increase of £15,000,000 to the bankers' balances would increase the gold reserve of the country by £6,750,000, and bring the average holding of the Bank of England in the Banking and Issue departments combined up to about £40,000,000. The reason for desiring to have a rather larger stock of gold at the Bank is that the export then of a few millions is of relatively less importance. But we do not want more than is requisite for the easy and safe working of our system. To sit on a hoard of unused gold is to do away with the advantages of banking. What is requisite is for this country to retain the power of attracting gold

when it is required. Neither the system of banking nor the bankers can give it that power, for it is dependent, not on them, but on the successful business energy and activity of the nation. Of course, in order to attract and retain here the amount of gold mentioned above, the Bank of England must adjust its rate to circumstances, but with the increasing supplies of gold, actual and prospective, a reasonable rate is likely to suffice."

These remarks caused some discussion, during which it was pointed out that under Mr. Tritton's proposal the banks would collectively form a gold fund of £15,000,000, at a cost to themselves of £450,000. Under Mr. Cole's proposal, however, for the banks to increase their balances at the Bank of England by the sum of £15,000,000, the extra gold held in the country would only be increased by the sum of £6,750,000 (according to the proportion of the reserve held to public liabilities, which has been 45 per cent. on an average for the last twenty years), while the Bank would make a considerable profit from the remainder of the increased balances—a profit earned entirely at the expense of the banks.

It was also pointed out that the requisite gold could be acquired by offering a slightly higher price for it, thus retaining imports of the metal which would otherwise be bought up by exporters. Finally, it was stated by one speaker of eminence in the banking world, that in his opinion the matter was not one for the banks to deal with alone, the additional gold not being required for the sole

benefit of the banks, but for the security of the community at large.

The matter here rests for the present, but when it has to be settled, as doubtless it must at some time, the ideas and suggestions contained in these discussions will probably become of importance.

INDEX

Active circulation, 59
Advances to customers, 92, 100
Amalgamations, 80, 164
Arbitrage, 13[illegible]

Bank Act of 1844: Main provisions of, 29; suspensions of, 35, 36, 38
— of France, 127, 149
— paper, 139
— post bills, 69
— rate, 74, 139, 143
— return: the first issued, 32
Bankers' balances, 65, 90
Banking department, 62
Berlin: specie points, 128
Bill brokers, 51, 90
— — guarantees, 108
Bills under discount, 92, 100
Board of Trade Returns, 154
Branch banks, 80, 164
Buying gold, 149

Call and short money, 50, 94, 147
Cash payments: suspension of, 12
'Change, 134
Circulation: active, 59
Clearing House, 79, 115
— — Returns, 119, 154

Closing prices, 160
Competition, 163
Continental investment in London bills, 140
Country clearing, 117
Course of exchange, 135

Deficiency bills, 70

Exchange: favourable or unfavourable, 128
— long, 136
— short, 136, 139
Exchequer bills, 51, 92
— — closure of by Charles II., 5
Export specie points, 126

Favourable exchange, 128
Fixed price of issue, 159
Floaters, 111
Fluctuations of exchange rates, 129
Foreign bankers, 46, 54, 110, 139

Gold movements, 123, 142
— reserves, 162, 169
Goldsmiths, 4, 19

Import specie points, 127
Indian Government, 52
— price of silver, 152
Investments, 91, 97, 99

Issue department, 57
— at fixed price, 159
— by tender, 158

Joint-stock banks, 19, 21, 49, 77

Limited liability, 79, 145
Liquid assets, 93
Lombards, 3
Long exchange, 136

Mexican dollars, 152
Money market, 47
Monopoly of joint-stock banking, 10, 15, 23, 76

New York specie points, 128

One-reserve system, 67, 162

Par of exchange, 125
Paris: specie points, 127
Post days, 134
Premises, 93–100

Rediscounting, 110
Reichsbank, 34, 128, 149

Reserve, 73, 143
— capital, 83
— funds, 83, 104
Royal Exchange, 1

Short exchange, 136,
— loan fund, 49, 11
Silver, 150
Specie points, 126
Stock Exchange, 52, 96, 136
Suspension of cash payments, 12
— Bank Charter Act, [illegible], 36, 38

Tender system, 158
Till money, 60, 90
Tower of London: moneys, 4
Trade bills, 106, 139
Traffic returns, 153
Treasury bills, 51, 148

Unfavourable exchange

Visible gold reserves,

Ways and means, 70
Window dressing, 95

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